IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-731

SUN OIL COMPANY, GENERAL CRUDE OIL COMPANY,
M. H. MARR, CONTINENTAL OIL COMPANY,
Petitioners,

v.

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION,
TEXAS EASTERN TRANSMISSION CORPORATION,
FEDERAL POWER COMMISSION,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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FEDERAL POWER COMMISSION,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Sun Oil Company, General Crude Oil Company, M. H. Marr and Continental Oil Company (Petitioners) petition for a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the District of Columbia Circuit entered March 25, 1974 and its order denying rehearing and supplemental opinion entered August 27, 1975, in this case.

OPINIONS BELOW

The initial opinion of the court of appeals (App. A, *infra*, pp. A1-A135), its order amending the initial opinion (App. B, *infra*, pp. B1-B3), and its supplemental opinion on rehearing (App. C, *infra*, pp. C1-C22) are not yet reported. The initial opinion (No. 565) of the Federal Power Commission (App. F, *infra*, pp. F1-F103), its opinion (No.

565-A) on rehearing (App. G, *infra,* pp. G1-G48) and its order denying rehearing of opinion No. 565-A (App. H, *infra,* pp. H1-H7) are reported at 42 FPC 376, 44 FPC 1079 and 44 FPC 1471.[1]

JURISDICTION

The judgment of the court of appeals was entered on March 25, 1974 (App. D, *infra,* pp. D1-D4) and petitions for rehearing were denied on August 27, 1975 (App. E, *infra,* pp. E1-E2). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTIONS PRESENTED

1. Did the court below act in conflict with decisions of the Fifth Circuit and this Court by ordering the Federal Power Commission to prescribe refunds by sellers of Southern Louisiana gas based upon an 18.5 cent per Mcf area rate contained in Commission Opinion No. 546 (SoLa I) which never became effective or final and was withdrawn *ab initio* by the Commission in its Opinion No. 598 (SoLa II) which was affirmed in *Placid Oil Company* v. *Federal Power Commission,* 483 F. 2d 880 (5th Cir. 1973) and *Mobil Oil Corporation* v. *Federal Power Commission,* 417 U.S. 283 (1974).

2. Did the court below err in holding that the Commission's power under Section 7(e) of the Natural Gas Act, 15 U.S.C. 717f(e), to attach reasonable terms and conditions to certificates of public convenience and necessity is so circumscribed by this Court's *Mobile-Sierra* rule as to

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[1] Because of their length, the Appendices to this Petition are presented in a separate volume which accompanies this Petition.

preclude the Commission from permitting Petitioners to collect payment for all gas produced over the life of the gas reserves as an essential part of the Commission's conventionalization of the sale of leases here involved.

STATUTE INVOLVED

The Natural Gas Act, June 21, 1938, c. 556, 52 Stat. 821-833, as amended, 15 U.S.C. 717-717W, provides in pertinent part, as follows:

> Section 7(e), 15 U.S.C. 717f(e);
> * * * [A] certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the * * * sale * * * covered by the application, if it is found * * * that the proposed * * * sale, * * * to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

STATEMENT

A. Background

This case arises from Petitioners' sale of leasehold interests in the Rayne Field, Southern Louisiana to an interstate natural gas pipeline company, Texas Eastern Transmission Corporation (Texas Eastern). Initially, the Federal Power Commission (Commission) certificated Texas Eastern to build facilities attaching the Rayne Field leases to its transmission system, but disclaimed jurisdiction over the sale of the leases.[2] On appeal, this Commission action was set aside and remanded. However, the reviewing court

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[2] *Texas Eastern Transmission Corp.,* 21 FPC 860, 864 (1959).

did not disturb the Commission's disclaimer of jurisdiction.[3] On remand, the Commission for the first time asserted jurisdiction over Petitioners' sale of leases.[4] In light of the Commission's initial disclaimer of jurisdiction, Petitioners as sellers of the Rayne Field leases had not until then been parties to the proceedings relating to Texas Eastern's acquisition of the leases.[5]

Petitioners appealed the Commission's assertion of jurisdiction and obtained its reversal at the court of appeals level.[6] This Court reversed the Fifth Circuit and upheld the Commission's jurisdiction over the sale of gas arising from the lease sale, *United Gas Improvement Co.* v. *Continental Oil Co.,* 381 U.S. 392 (1965). This Court noted that "the propriety of the Commission's disposition of the case following its assertion of jurisdiction" was not before it and that only the jurisdictional question was being decided, *id.* at 399.

As a result of this Court's jurisdictional holding, each Petitioner filed an application for a certificate of public convenience and necessity, pursuant to Section 7(c) of the Natural Gas Act, 15 U.S.C. 717f(c), seeking Commission authorization of the sale of gas effected by its conveyance of leases to Texas Eastern. As discussed *infra,* the Commission issued certificates to Petitioners subject to conditions which were attacked by Petitioners and other

[3] *Public Service Commission of the State of New York* v. *Federal Power Commission,* 287 F.2d 143, 145 (D.C. Cir. 1960).

[4] *Texas Eastern Transmission Corp.,* 29 FPC 249, 253 (1963).

[5] In reliance upon the Commission's disclaimer of jurisdiction, Petitioners consummated the sale of the leases by conveying them to Texas Eastern on July 27, 1959.

[6] *M. H. Marr* v. *Federal Power Commission,* 336 F.2d 320, 325-26 (5th Cir. 1964).

parties before the court of appeals below.[7] The court below has affirmed the Commission in part but substantially altered to Petitioners' detriment the conditions imposed by the Commission upon the certificates.

This petition is addressed to the disposition of the court below upon its review of the Commission's opinion and order issuing conditioned certificates to Petitioners.

B. Proceedings Before The Commission

Petitioners sought Commission certificate authorization of the sale of natural gas in accordance with the terms and provisions of the lease sale agreement with Texas Eastern. This agreement provided for the assignment and conveyance of Petitioners' Rayne Field leases in consideration of $134,395,700 consisting of a cash payment of $12,420,500 and the remainder payable by serial notes maturing over a 16-year period. Petitioners also reserved a production payment applicable to the proceeds from the condensate liquids produced by Texas Eastern until 613,406,770 Mcf of natural gas had been produced from which Texas Eastern's costs of operating the Field were deducted. Upon termination of the production payment, Texas Eastern would retain the condensate liquid proceeds.

On August 6, 1969, the Commission issued Opinion No. 565 (App. F, *infra,* pp. F1-F103) accepting the hearing examiner's recommendation that the lease sale agreement should be substantially modified so as to make it more comparable to a conventional sale of gas. In implementation of its "conventionalizing" approach, the Commission provided that payments to Petitioners for gas thereafter produced by Texas Eastern from Rayne Field would not exceed

[7] The jurisdiction of the court below was invoked by petitions to review the Commission's action pursuant to Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

18.5 cents per Mcf[8] (or other applicable area prices determined by it) until the $134,395,700 purchase price had been paid (*id.* at F42). It further directed Petitioners to refund amounts collected from Texas Eastern under the terms of the lease sale agreement which exceeded 20 cents per Mcf[9] for the period prior to October 1, 1968 and 18.5 cents per Mcf thereafter until the date of refund. Through 1967, this refund amounted to $31,449,000 inclusive of interest (*id.* at F26-F27).

Applications for rehearing of Opinion No. 565 were filed by Petitioners and others. On September 29, 1970, the Commission issued Opinion No. 565-A on rehearing (App. G, *infra*, pp. G1-G48). While confirming the "conventionalization" approach adopted in Opinion No. 565, it stated that "the arrangement prescribed in our original opinion and order should be modified so as to bring it closer to a conventional sale" (*id.* at G4).

To accomplish this objective, the Commission modified its original "conventionalization" of the lease sale agreement in two important respects. First, it provided that Petitioners would receive payment from Texas Eastern for the gas produced from the transferred leases until their exhaustion as well as credit for the revenues from the liquids produced. Second, it deferred refunds by Petitioners

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[8] Subsequent to the hearing examiner's decision, the Commission had issued its first opinion in the *Southern Louisiana Area Rate Proceeding,* setting forth an area rate of 18.5 cents per Mcf for gas sold pursuant to pre-1961 contracts, Opinion No. 546 issued September 25, 1968 (40 FPC 530). This rate was stayed, never made effective, and was withdrawn by Opinion No. 598 (46 FPC 86).

[9] The 20-cent refund base for the period prior to October 1, 1968 was the "in-line" price determined by the Commission for conventional sales of gas in Southern Louisiana of the same vintage as the sale of the Rayne Field leases (*id.* at F12).

until just and reasonable rates had been finally established for the Southern Louisiana area and provided that such rates, when determined, would apply retrospectively for refund purposes. The Commission found these modifications to be required by the public convenience and necessity (*id.* at G4-G5).

The first modification extending payments to Petitioners for gas and liquids over the life of the transferred leases recognized that although Petitioners would be permitted to recover $134,395,700 under the "conventionalization" arrangement prescribed in Opinion No. 565, that amount would be of substantially less value because it would be collected over a much longer period than provided by the lease sale agreement. Without this modification, the Commission stated, Petitioners "will not receive the benefit of all the gas and liquids produced by the Field as they would under a conventional contract" (*id.* at G10-G11).

In support of its second modification, *i.e.,* deferral of refunds pending final determination of the Southern Louisiana area rates, the Commission pointed out that as a result of judicial review of its first *Southern Louisiana* Opinion No. 546, the Fifth Circuit confirmed the Commission's authority to modify any part of its *Southern Louisiana* orders "including those affecting revenues from gas already delivered, and to make retrospective as well as prospective adjustments in the public interest" (*id.* at G13).[10] The Commission noted that, as a result, it had

[10] This quoted language paraphrases the following language of the Fifth Circuit in its order of June 16, 1970 on rehearing in *Southern Louisiana Area Rate Cases* (*Austral Oil Co.* v. *FPC*), 444 F. 2d 125, 126-7, involving review of the Commission's Opinion No. 546:

> . . . We wish to make crystal clear the authority of the Commission in this case to reopen *any* part of its order that circumstances require be reopened. Under Section 19(b)

stayed the effect of its rate orders in Opinion No. 546.[11] In these circumstances, the Commission found that "the public interest precludes our ordering refunds to be paid by the Rayne Field producers at this time" (*id.* at G14). Additionally, the Commission observed that refund deferral would achieve the important objective of affording Petitioners "the same treatment as will be given to all other producers in Southern Louisiana" (*ibid.*). The Commission concluded that the finally determined area rates for Southern Louisiana[12] "should govern the level of payments in this case prior to October 1, 1968, as well as after that date" (*ibid.*).

Applications for rehearing of Opinion No. 565-A were filed by Petitioners and others and denied by the Commission's order issued November 24, 1970 (App. H, *infra,* pp. H1-H7).

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of the Natural Gas Act, this Court has the broad remedial powers that inhere in a court of equity, and pursuant to our equitable powers we make it part of the remedy in this case that the authority of the Commission to reopen any part of its orders, including those affecting revenues from gas already delivered, is left intact. The Commission can make retrospective as well as prospective adjustments in this case if it finds that it is in the public interest to do so. [emphasis in original]

[11] Order Continuing Stay, issued July 2, 1970, in *Southern Louisiana Area Rate Proceedings,* Docket No. AR61-2, *et al.,* 44 FPC 6.

[12] Final area rates for Southern Louisiana were determined by the Commission's Opinion No. 598, issued July 16, 1971, 46 FPC 86. On review, Opinion No. 598 was affirmed by the Fifth Circuit *sub nom. Placid Oil Co.* v. *FPC,* 483 F.2d 880 (1973) which was thereafter affirmed by this Court *sub nom. Mobil Oil Corp.* v. *FPC,* 417 U.S. 283 (1974). In its affirmance, this Court made clear that the Commission's first *Southern Louisiana* opinion (Opinion No. 546) had never become final "and thus it was within the power of the Commission to reconsider and change it" (*id.* at 312) as it did in Opinion No. 598.

C. The Decision Below

On petitions for review, the court below affirmed the Commission's refusal to unconditionally certificate Petitioners, but reversed the Commission by abrogating certain important conditions which the Commission had attached to the certificates of public convenience and necessity granted to Petitioners. In lieu thereof, the court below substituted its own certificate conditions which it found to be legally required (App. A, *infra,* pp. A1-A135). In a supplemental opinion accompanying its order denying rehearing, the court largely reiterated its reasoning and found no change in its original determination warranted (App. C, *infra,* pp. C1-C22).

While sustaining in principle the Commission's determination to "conventionalize" the lease sale agreement (App. A, *infra,* pp. A32-A48), the court found certain aspects of the Commission's "conventionalization" legally impermissible. In Opinion No. 565-A, the Commission had deferred refunds by Petitioners pending its determination of final area rates for the Southern Louisiana area where the Rayne Field leases are located. For the same reason, the Commission required Petitioners to file a 20-cent rate applicable to future production. The court below held that the Commission was compelled to utilize 18.5 cents as the basis for refunds and for future production and to order immediate refunds by Petitioners (*id.* at pp. A73-A74). The court reasoned that the foregoing was required because in 1968 the Commission had stated 18.5¢ to be the applicable just and reasonable rate for Southern Louisiana gas of the Rayne Field vintage. The court below rejected the Commission's explanation that the 18.5¢ rate had never become final and would be superseded, retrospectively and prospectively, by its final area rate determination which issued on July 16, 1971

as Opinion No. 598, 46 FPC 86. In Opinion No. 565-A, the Commission had expressly stated that its final area rate determination when issued would apply in full to the instant proceeding (App. G, *infra*, p. G14). Nevertheless, the court below found that Opinion No. 598 could not be applied to this proceeding except after August 1, 1971, its effective date (App. A, *infra*, pp. A130-A133).

The court below also abrogated the "conventionalizing" condition imposed by the Commission in Opinion No. 565-A permitting Petitioners to receive payment for the gas produced and credit for the liquid revenues until exhaustion of the transferred leases. The Commission had found this condition to Petitioners' certificates necessary in order to bring the previously prescribed arrangement "closer to a conventional sale" (App. G, *infra*, p. G4). The court below, nevertheless, was of the view that the Commission had not found this condition to be "essential to conventionalization of the lease-sale arrangement" (App. A, *infra*, pp. A68-69). Assuming that the Commission's "conventionalizing" condition increased the $134,395,700 price contained in the lease sale agreement, the court found that the Commission was not empowered to accomplish this result under this Court's *Mobile-Sierra* rule (App. A, *infra*, pp. A64, A67).[13] In lieu of the life-of-reserves condition imposed by the Commission, the court below fashioned its own certificate condition noting that by limiting Texas Eastern's liability to the contract price and simultaneously spreading its discharge over a longer period of time than contemplated by the lease sale agreement, Petitioners would receive less than "the *quid pro quo* for which they contracted" (*id.* at pp. A69-A70). Accordingly, the court directed the Commission

[13] *United Gas Pipe Line Co.* v. *Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956); *FPC* v. *Sierra Pacific Power Company*, 350 U.S. 348 (1956).

to provide for "an increase in Texas Eastern's payments beyond the $134 million contract price by an amount equal to the time value of the money to be paid on the Commission-rearranged payment schedule" (*id.* at p. A71).

REASONS FOR GRANTING THE WRIT

1. Conflict With Decisions Of This Court And Fifth Circuit

The court below directed the Commission to order refunds by Petitioners down to an 18.5 cent per Mcf level, set forth in Commission Opinion No. 546,[14] rather than on the basis of the higher rates ultimately approved for refund purposes for the Southern Louisiana area in Commission Opinion No. 598.[15] This directive is in direct conflict with the decisions of this court[16] and the Court of Appeals for the Fifth Circuit,[17] which determined that Commission Opinion No. 546 never established valid and effective rates for determining producer refunds relating to sales in the Southern Louisiana area.

The history of Southern Louisiana area rate making is long and complex. Following its first efforts to determine producer rates for interstate sales of natural gas on an area basis,[18] the Commission launched the Southern Louisiana area rate proceeding in 1961. By its first opinion, Opinion No. 546 issued September 25, 1968, the Commission

[14] *Southern Louisiana Area Rate Proceeding* (SoLa I), 40 FPC 530 (1968).

[15] *Southern Louisiana Area Rate Proceeding* (SoLa II), 46 FPC 86 (1971).

[16] *Mobil Oil Corporation* v. *Federal Power Commission*, 417 U.S. 283 (1974).

[17] *Placid Oil Company* v. *Federal Power Commission*, 483 F.2d 880 (1973).

[18] *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

purported to set rates for sales of natural gas under contracts made prior to 1961 at 18.5 cents per Mcf. On review, Opinion No. 546 was considered by the Fifth Circuit, which expressed its dissatisfaction with the Commission's efforts in setting rates for the Southern Louisiana area, and "affirmed" Opinion 546, but with clear instructions to the Commission as to its latitude to reconsider the Opinion 546 rates. *Austral Oil Company* v. *Federal Power Commission*, 428 F.2d 407 (5th Cir. 1970). The Commission itself, reflecting its own dissatisfaction with the rates purportedly set by Opinion 546, had already commenced the second round of the Southern Louisiana area rate hearings in 1969, even prior to the Fifth Circuit's decision in *Austral*. On rehearing of its *Austral* decision, the Fifth Circuit emphatically pointed out that its "affirmance" of Opinion 546 did not impair the Commission's ability to alter or modify any of the provisions, particularly refund provisions, of Opinion 546, retrospectively and prospectively.[19]

The rates set forth in Opinion 546 never became effective as to any sales of natural gas in the Southern Louisiana area. The Commission and the Fifth Circuit granted continuing stays of Opinion 546 which rendered it nonoperative and ineffective in all respects from the date of its issuance and it was formally withdrawn in all respects by the Commission's Opinion No. 598, which culminated the Southern Louisiana area rate proceeding. Opinion 598 determined higher rates for natural gas in Southern Louisiana for all applicable time periods as to which Opinion 546 had first been intended to apply. The Commission in Opinion 598 expressly vacated the refund provisions and rate levels for refunds set forth in Opinion 546. Opinion 598 comprehensively covered all Southern Louisiana producer

[19] *Austral Oil Company* v. *Federal Power Commission*, 444 F.2d 125, 126-27 (1970).

refunds for all periods of time from the advent of producer regulation in 1954 and rendered Opinion 546 a nullity in every respect.

The Commission's abrogation and withdrawal of Opinion 546 was expressly considered by the Fifth Circuit in *Placid Oil Company* v. *Federal Power Commission*, 483 F.2d 880 (1973). That court affirmed completely the Commission's action in Opinion 598 aborting Opinion 546 for all purposes. Notwithstanding this decision by the Fifth Circuit, the court below[20] has attempted to resurrect Opinion 546 as the basis for directing the Commission to order refunds by Petitioners.

In petitions for rehearing before the court below, Petitioners pointed out the conflict between the court's initial opinion resurrecting Opinion 546 and the decision of the Fifth Circuit affirming the Commission's repudiation of Opinion 546. Following the petitions for rehearing, but prior to the supplemental opinion below,[21] this Court affirmed in all respects the decision of the Fifth Circuit in *Placid, supra*, which had affirmed the Commission's complete redetermination of Southern Louisiana area rates and refunds in Opinion 598. *Mobil Oil Corporation* v. *Federal Power Commission*, 417 U.S. 283 (1974). Notwithstanding the clear decisions of the Fifth Circuit and this Court in affirming the Commission's total repudiation of Opinion 546 for any purpose, the court below upon rehearing refused to modify its initial opinion thereby creating an irreconcilable conflict between its opinion and the decisions of the Fifth Circuit in *Placid, supra*, and this Court in *Mobil, supra*.

[20] Appendix A, *infra*.

[21] Appendix C, *infra*.

This Court in *Mobil* expressly dealt with the lack of finality of the rate and refund provisions of Opinion 546, and affirmed the Commission's action in Opinion 598 discarding Opinion 546. As the Court stated in *Mobil, supra,* 417 U.S. at 310-312:

> Before reviewing the Court of Appeals' affirmance of the Commission's 1971 order [Opinion 598] for compliance with *Permian's* requirements, we address contentions that challenge the statutory authority of the Commission to adopt the order, rather than the terms of the order itself. The first of these challenges, made by New York and MDG is that the Commission had no statutory authority to change rates and refund obligations fixed in the Commission's 1968 order [Opinion 546] after that order was affirmed by the Court of Appeals in *SoLa I.* MDG brief, at p. 18; New York brief, at p. 15. The argument is that the affirmance was "unqualified" and therefore exhausted the Court of Appeals' powers of review under § 19(b), thus rendering its authorization to the Commission to reopen its 1968 orders without legal effect. But the affirmance of the 1968 order was not "unqualified." Although the Commission could not have reopened the order on its own, see *Montana-Dakota Utilities Co.* v. *Northwest Public Service Co.,* 341 U.S. 246, 254 (1951); *FPC* v. *Hope Natural Gas Co.,* 320 U.S. 591, 618 (1944), the Court of Appeals' opinion on rehearing made it "crystal clear" that despite the form of the court's judgment, the Commission was fully authorized to reopen any part of the 1968 order that seemed appropriate and necessary if evidence as to the future supply problem indicated that this should be done.
>
> The Court of Appeals properly took this step in light of new information, unavailable at the time of the 1968 order, that suggested the possible inadequacy of the 1968 determination, although not necessarily an inadequacy that justified setting aside the order. See *Baldwin* v. *Scott County Milling Co.,* 307 U.S. 478 (1939). Moreover, the 1968 order had not been made

> effective, being continuously stayed until withdrawn in the 1971 order. See 46 F.P.C., at 101. In these circumstances, we cannot say that the action of the Court of Appeals exceeded its powers under § 19(b) "to affirm, modify, or set aside [an] order in whole or in part."
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> This jurisdiction to review the orders of the Commission is vested in a court with equity powers, *Natural Gas Pipeline Co.* v. *FPC,* 128 F.2d 481 (1942), see *Ford Motor Co.* v. *NLRB,* 305 U.S. 364, 373 (1938), and we cannot say that the Court improperly exercised those powers in the circumstances. *Dolcin Corp.* v. *FTC,* 219 F.2d 742, 750-752 (1955). Indeed § 19(b) provides that the Court of Appeals may authorize in proper cases the Commission to take new evidence, upon which the Commission may modify its findings of fact and make recommendations concerning the disposition of its original order. Under the Court of Appeals disposition, the 1968 order was therefore not final and thus it was within the power of the Commission to reconsider and change it. See *United Gas Improvement Co.* v. *Callery Properties,* 382 U.S. 223, 229 (1965). [Footnote omitted]

The Fifth Circuit in *Placid, supra,* also unequivocally held that the Commission's Opinion 546 had no effect and was rendered nugatory by the Commission's subsequent action in Opinion 598. The Fifth Circuit expressly decided that the prior refund determination under the Commission's Opinion 546 had been superseded *ab initio* and rendered for naught by the Commission's Opinion 598, notwithstanding the Fifth Circuit's previous qualified "affirmance" of Opinion 546. That court in *Placid* rejected the argument that the prior refund obligation in Opinion 546 was affirmed and that Opinion 546 was therefore controlling for refund purposes, stating as follows:

> For there [in *Austral*] we categorically rejected the notion that the label 'affirmance' could possibly impair FPC's ability to alter or modify *any* of the provisions, particularly the refund provisions of its SoLa I [Opinion 546] rate scheme if it believed that the exigencies of the gas industry required more effective remedial measures. 483 F.2d at 904.

Thus, the Fifth Circuit in *Placid* and this Court in *Mobil* affirmed the Commission's action in Opinion 598 in setting aside the rates and refunds established under its earlier Opinion 546.

The Commission itself had made eminently clear in Opinion 598 that it was abrogating in all respects, retrospectively as well as prospectively, its earlier Opinion 546. The Commission noted that the Fifth Circuit in *Austral* had specifically directed that the Commission had the authority to change its Opinion 546 rate and refund determinations retrospectively and the Commission took that direction to heart as telling it to use such authority and make changes retrospectively in the refund and rate determinations for Southern Louisiana. The Commission expressly relied upon the Fifth Circuit's decision on rehearing in *Austral*, stating in Opinion 598, 46 FPC at 100:

> . . . In the opinion of March 19, 1970, the court [in *Austral*, 428 F.2d at 444-5] had said specifically:
>
> > The mandate of this Court should not, however, be interpreted to interfere with Commission action that would change the rates we have approved here.
>
> In its order on the petition for rehearing [444 F.2d at 126-27] . . . the court went further:
>
> > . . . We wish to make crystal clear the authority of the Commission in this case to reopen any part of its order that circumstances require be reopened. Under Section 19(b) of the Natural Gas Act, this Court has

> > the broad remedial powers that inhere in a court of equity, and pursuant to our equitable powers, *we make it part of the remedy in this case that the authority of the Commission to reopen any part of its orders, including those affecting revenues from gas already delivered, is left intact. The Commission can make retrospective as well as prospective adjustments in this case if it finds that it is in the public interest to do so.* [Emphasis added by Commission.]
>
> That language is authoritative, and we strive herein to follow it as the law of this case, and as sound in any event. [Footnote omitted]

The Commission in Opinion 598 further expressly stated the effect of that opinion in abrogating all refund provisions of the earlier Opinion 546, again relying on its authority under *Austral,* stating (46 FPC at 140):

> The Fifth Circuit recognized the Commission's power to review and revise refunds in these proceedings, indicating '. . . it may be that the refunds are too burdensome in light of new evidence to be in the public interest.' Moreover, the Natural Gas Act makes it explicitly clear that the Commission *may* order refunds. [Footnotes omitted]

The Commission thereupon set forth the applicable refund provisions for Southern Louisiana, which would apply retrospectively to all prior periods of time, in lieu of the provisions of Opinion 546.

Despite the Fifth Circuit's affirmance in *Placid* of the Commission's Opinion 598, which repudiated Opinion 546, the court below in its initial opinion directed that Opinion 546 be used as the basis for refunds by Petitioners.

While rehearing was pending before the court below, this Court announced its decision in *Mobil* affirming the Fifth Circuit in *Placid*. Nevertheless the court below re-

fused to modify its decision to obviate clear conflict with this Court and the Fifth Circuit, and continued to impute to Opinion 546 a finality and validity which it does not have under *Austral, Placid* and *Mobil, supra.* Thus, in its supplemental opinion on rehearing, the court below stated (App. C, *infra,* p. C18):

> In our previous opinion we disagreed with the Commission that the accompanying circumstances 'rendered Opinion No. 546 so tentative in character as to support the Commission's refusal in Opinion No. 565-A to employ the 18.5-cent just and reasonable rate as the initial price to be paid to the producers for gas delivered after the effective date of that rate.' On the same ground, we disagreed with the position that that rate could not serve as the predicate for refunds by the producers on account of deliveries before that date at higher prices. (Footnotes omitted)

The court then continued in its supplemental opinion to adhere to the use of Opinion 546 in spite of this Court's decision in *Mobil,* stating (App. C, *infra,* p. C21):

> We remain of the view, however, that with the still unrevised 18.5 cent [Opinion 546] just and reasonable area rate available, the Commission was legally obligated to give it preference.

The court below grossly misconceived the status of Opinion 546 when it referred to "the still unrevised 18.5 cent" area rate set forth therein, implying that that rate had force and effect at the time Opinion 565-A herein issued. The court's assumption that Opinion 546 had effect until July, 1971, when Opinion 598 issued, is totally inconsistent with the Commission's judicially sanctioned action and rationale in expressly repudiating Opinion 546 retrospectively. It necessarily follows that the court's position below is in direct conflict with *Placid* and *Mobil* affirming the Commission's retrospective abrogation of Opinion 546 for refund purposes.

Under the decision of the court below the four Petitioners would, as a consequence of only one sale in the Southern Louisiana area, be required to refund an estimated 70 million dollars. This is in stark contrast to a total refund obligation of only 150 million dollars for the entire producing industry attributable to all sales since 1954 in Southern Louisiana subject to refund in the area rate case. In the Southern Louisiana area rate case, the abrogation and withdrawal of Opinion 546 by Opinion 598 reduced industry-wide refund obligations from an estimated 375 million dollars to 150 million dollars. By its misplaced reliance upon Opinion 546, the court below increased the four Petitioners' refunds by an estimated 26 million dollars.[22] The conflicting application of Opinion 546 for refund purposes by the court below impugns the Commission's authority under *Placid* and *Mobil* to change its Southern Louisiana rate and refund determinations. The decision below would emasculate the broad authority of the Commission under *Austral, Placid* and *Mobil* to reopen and modify retrospectively any of its orders.

The erroneous application of Opinion 546 by the court below also imposes upon Petitioners exceptionally discriminatory adverse treatment when compared with the producing industry as a whole. This discriminatory treatment

[22] Under Opinion 598 rate levels, refunds were required for the period prior to January 1, 1965, on amounts in excess of 20.625¢/Mcf; and for the period from January 1, 1965, to October 1, 1968, at 21.25¢/Mcf; thereafter, until January 1, 1971, refunds were required on the basis of 30.5% of excess revenues as defined in Opinion 598 (46 FPC 86 at 140). From January 1, 1971, until August 1, 1971, the effective date of Opinion 598, refunds were based entirely on the Opinion 598 levels, which prescribed 22.375¢/Mcf for onshore Louisiana sales.

is sufficiently grave to deprive Petitioners of substantive due process of law.

To resolve the conflict between the decision of the court below and those of the Fifth Circuit in *Austral* and *Placid* and this Court in *Mobil*, the writ for certiorari should be granted.

2. The Commission's Authority To Extend Payment For The Life Of The Reserves

Section 7(e) of the Natural Gas Act (p. 3, *supra*) empowers the Commission to issue certificates of public convenience and necessity subject to "such reasonable terms and conditions as the public convenience and necessity may require." In the exercise of an administrative agency's certificating function, it "has been entrusted with a wide range of discretionary authority," *United States* v. *Detroit & C. Nav. Co.*, 326 U.S. 236, 241 (1945); *accord, Federal Power Commission* v. *Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 7-8 (1961). Finding that the lease sale agreement in this case could not be unconditionally certificated in the public interest, the Commission issued conditioned certificates to Petitioners which substantially modified the lease sale agreement with the intention of making it more comparable to a conventional sale of gas.[23]

While deferring in principle to the Commission's restructuring of the lease sale agreement by conventionalizing certificate conditions (App. A, *infra*, pp. A32-A48), the court below set aside the fundamental life-of-reserves certificate condition imposed by the Commission for the expressed purpose of bringing the conventionalized arrangement

[23] Under a conventional sale, a producer sells gas as produced on a cents-per-Mcf basis for a term of years or for the life of the lease. Here the leases are sold for life, necessarily fixing that term.

"closer to a conventional sale" (App. G, *infra*, p. G4). This condition provides that Petitioners will be paid on a cents-per-Mcf basis for all gas produced by Texas Eastern during the life of the transferred leases, just as they would have been under a conventional sale of gas. The court below held that the life-of-reserves condition runs afoul of this Court's *Mobile-Sierra* rule[24] (App. A, *infra*, p. A64), which provides that the rate change provisions of the Natural Gas Act, 15 U.S.C. 717 *et seq.*, and the Federal Power Act, 16 U.S.C. 791a, *et seq.*, do not give natural gas companies or electric utilities the right to increase contract rates by unilateral filings, absent a Commission determination that the contract rate is so low as to conflict with the public interest, *United Gas Pipe Line Co.* v. *Mobile Gas Servicing Corp.*, 350 U.S. 332, 345 (1956).[25]

The Court below was of the erroneous view that this Court's CATCO decision[26] established that "the *Mobile-Sierra* rule applies full force to Section 7 proceedings" (App. A, *infra*, p. A67). This is not apparent from a reading of CATCO. The Court's reference in CATCO to its *Mobile* decision obviously related to the circumstances then before it, *Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378, 391-92 (1959). It is not reasonable to assume that the Court intended to preclude the Commission from exercising its broad conditioning power in the public interest to modify an unsual sales transaction to make it conform to a conventional sale of gas.

[24] *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956); *Federal Power Commission* v. *Sierra Pacific Power Company*, 350 U.S. 348 (1956).

[25] The court below proceeded on the premise that the life-of-reserves certificate condition may increase the $134,395,700 price contained in the unconventionalized lease sale agreement (App. A, *infra*, pp. A64-A66). This premise is not presently susceptible to proof.

[26] *Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378 (1959).

Unlike Catco, the Commission did exercise its certificate conditioning power in the case-at-bar to equate Petitioners' lease sale agreement to a conventional sale of gas. The Commission concluded that unless Petitioners were allowed to receive payment for the gas produced over the life of the transferred leases, Petitioners would be deprived of an essential feature of a conventional sale (App. G, *infra*, pp. G4, G10-G11).

The Commission supported its modified conventionalization with two undisputed reasons: (1) receipt of the $134 million set forth in the unconventionalized lease sale agreement would be of substantially less value to Petitioners because it would be received over a much longer period than contemplated by that agreement and (2) limiting Petitioners to the $134 million would deprive them of the benefit, inherent in a conventional sale for life-of-reserves, of receiving payment for the gas produced over the life of the dedicated leases (*id.* at G10-G11).

In setting aside the life-of-reserves condition, the court below erroneously held that the Commission had not found such condition to be "essential to conventionalization of the lease sale arrangement" (App. A, *infra*, pp. A68-A69). Indeed, the Commission expressly so found (App. G, *infra*, p. G4). The Commission's life-of-reserves condition is soundly based upon fact and reason and is not in conflict with the Court's Catco decision, *supra* at 391.[27] In Opinion No. 565, the Commission literally mandated the lease sale agreement out of existence by conventionalizing conditions. Thereafter in Opinion No. 565-A, it modified its initial prescription by imposing the life-of-reserves condi-

[27] As the Court stated (360 U.S. at 391): ". . . The Congress, in § 7(e), has authorized the Commission to condition certificates in such manner as the public convenience and necessity may require."

tion in order to reach a more equitable result consonant with its objective of conventionalization. In so doing, the Commission acted properly within its exclusive province as arbiter of the public convenience and necessity.

The reliance of the court below upon this Court's *Mobile-Sierra* rule[28] as the basis for setting aside the certificate condition in question is misplaced, as indicated above. In lieu of the Commission's life-of-reserves condition, however, the court below has substituted its own condition in recognition of Petitioners' "plight" as a result of the conventionalization prescribed by Opinion No. 565 (App. A, *infra*, pp. A69-A71). Thus, it has directed the Commission to increase Texas Eastern's payments "beyond the aggregate $134 million contract price by an amount equal to the time value of the money to be paid on the Commission-rearranged payment schedule" (*id.* at A71).[29] Characterizing its own condition as "the only alternative legally available to the Commission," the court below has incorporated it as an integral part of its judgment (*ibid.*).

[28] *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, *supra*; *Federal Power Commission* v. *Sierra Pacific Power Company*, *supra*.

[29] There is no way to determine from the administrative record below, closed in 1968, whether this court-mandated condition, the Commission's life-of-reserves condition, or the lease sale unconditionally certificated, would be more in the public interest. By this assignment of error, Petitioners do not imply the acceptability to them of the Commission's life-of-reserves condition. It may be less harmful to them than the court-fashioned substitute but they continue to contend that the unconditioned lease sale best serves the public interest, and is the only form acceptable to them as a basis for implementing their conditional unilateral proposal to reimburse Texas Eastern for a short fall of reserves. The court below erroneously assumed this proposal to be a bilateral agreement with Texas Eastern (App. A, *infra*, p. A15, n.40; See *contra*, *id.* at pp. A109-A110, n.540).

The substitution of the court-fashioned condition constitutes an impermissible intrusion upon the Commission's province and the exercise of "an essentially administrative function," *Federal Power Commission* v. *Idaho Power Company*, 344 U.S. 17, 21 (1952) *National Labor Relations Board* v. *Food Store Employees Union*, 417 U.S. 1 (1974). On remand the Commission needs a free hand to examine eight years of intervening facts, to determine what conditions, if any, are now justified. It may well agree with Petitioners, and two of the five Commissioners dissenting in Opinion No. 565-A, that the lease sale agreement should be certificated without conditions.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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November 17, 1975

No. 75-731

In The

Supreme Court of the United States

October Term 1975

Sun Oil Company, General Crude Oil Company,
M. H. Marr, Continental Oil Company,

Petitioners,

v.

Public Service Commission of the State of New York,
Philadelphia Gas Works Division of UGI Corporation,
Texas Eastern Transmission Corporation,
Federal Power Commission,

Respondents.

On Petition for A Writ of Certiorari
to the United States Court of Appeals
for the District of Columbia Circuit

APPENDICES TO PETITION FOR WRIT OF CERTIORARI

FIDELITY PRINTING COMPANY, HOUSTON

APPENDIX A

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT DECIDED MARCH 25, 1974

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 24,716

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

TEXAS EASTERN TRANSMISSION CORPORATION, SUN OIL COMPANY, GENERAL CRUDE OIL COMPANY, CONTINENTAL OIL COMPANY, AND M. H. MARR,
Intervenors

No. 24,823

SUN OIL COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

TEXAS EASTERN TRANSMISSION CORPORATION AND PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION,
Intervenors

No. 24,824

General Crude Oil Company,

Petitioner,

v.

Federal Power Commission,

Respondent.

Texas Eastern Transmission Corporation and
Philadelphia Gas Works Division of
UGI Corporation,

Intervenors

No. 24,825

M. H. Marr,

Petitioner,

v.

Federal Power Commission,

Respondent.

Texas Eastern Transmission Corporation and
Philadelphia Gas Works Division of
UGI Corporation,

Intervenors

No. 24,836

Continental Oil Company,

Petitioner,

v.

Federal Power Commission,

Respondent.

Texas Eastern Transmission Corporation and
Philadelphia Gas Works Division of
UGI Corporation,

Intervenors

No. 24,846

Texas Eastern Transmission Corporation,

Petitioner,

v.

Federal Power Commission,

Respondent.

Sun Oil Company, Continental Oil Company,
M. H. Marr, General Crude Oil Company, and
Philadelphia Gas Works Division of
UGI Corporation,

Intervenors

Petitions for Review of Orders of the
Federal Power Commission

Decided March 25, 1974

Morton L. Simons for petitioner in No. 24,716.

Bruce R. Merrill, with whom *Tom Burton, Stanley Morley* and *Francis H. Caskin* were on the brief, for petitioners in Nos. 24,823, 24,824, 24,825 and 24,836 and intervenors Sun Oil Company, General Crude Oil Company, Continental Oil Company and M. H. Marr in Nos. 24,716 and 24,846.

J. Evans Attwell for petitioner in No. 24,846 and intervenor Texas Eastern Transmission Corporation.

Kenneth E. Richardson, Attorney, Federal Power Commission, with whom *Gordon Gooch,* General Counsel, and *J. Richard Tiano,* Assistant Solicitor, Federal Power Commission, were on the brief, for respondent. *Israel Convisser,* Attorney, Federal Power Commission at the time the record was filed, also entered an appearance for respondent.

William T. Coleman, Jr., was on the brief for intervenor Philadelphia Gas Works Division of UGI Corporation in Nos. 24,823, 24,824, 24,825, 24,836 and 24,846.

Before FAHY, *Senior Circuit Judge,* and TAMM and ROBINSON, *Circuit Judges.*

Opinion for the Court filed by *Circuit Judge* ROBINSON.

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Robinson, *Circuit Judge:* We are called upon to review three orders promulgated by the Federal Power Commission in lengthy proceedings arising and conducted under the Natural Gas Act.[1] The Commission has granted four producers of natural gas leave to sell their leasehold interests in substantial proven reserves to an interstate pipeline, and the pipeline authority to construct and operate facilities enabling it to take gas therefrom. These grants have, however, been conditioned upon terms which are continuing subjects of complaint by the producers, the pipeline, and other as well.

The producers are Sun Oil Company, General Crude Oil Company, M. H. Marr and Continental Oil Company. The pipeline is Texas Eastern Transmission Corporation (Texas Eastern).[2] Other litigants in this court are the Public Service Commission of the State of New York (PSC) and the Philadelphia Gas Work of UGI Corporation (PGW).[3]

The orders under attack emanate from a series of Commission proceedings extending over a period of more than thirteen years. But notwithstanding its longevity, the controversy arrived here in a posture far from a final resolution. We have painstakingly examined its diffuse history, analyzed its multifaceted issues and pondered the complex problems emerging. Then, finding and identifying error in their administrative treatment, we are led to a disposition which, fortunately, will bring this long-standing litigation to a just and early end.

[1] Act of June 21, 1938, ch. 556, 52 Stat. 821, as amended, 15 U.S.C. §§ 717 *et seq.* (1970).

[2] Texas Eastern operates a pipeline system extending from Texas to the Northeast. Its principal markets are in New England and the Middle Atlantic region.

[3] PGW, a customer of Texas Eastern, operates under contract the municipally-owned gas facilities serving some 600,000 consumers in Philadelphia.

I. Background of the Litigation

A. *Producer-Pipeline Transactions*

By contracts executed on February 1, 1957, the producers agreed to sell, and Texas Eastern to buy, their natural gas production in Rayne Field,[4] in Southern Louisiana, at an initial price of 23.9 cents per Mcf.[5] Shortly thereafter, the producers applied to the Commission for certificates of public convenience and necessity authorizing the sale,[6] and Texas Eastern sought a certificate permitting construction of new pipeline facilities extending its system to Rayne Field.[7] Because the unit price specified by the contract was high,[8] the applications were opposed by PSC and nine distributor intervenors. Hearings were held and on April 15, 1958, the presiding examiner recommended that the sale and the construction be unconditionally certificated.[9] Exceptions to the examiner's decision were noted, but before the Commission ruled on them the Court of Appeals for the Third Circuit rendered its decision in the so-called *CATCO* litigation,[10] reversing an earlier Com-

[4] At the time, Rayne Field was a large and fully developed gas reserve uncommitted to serving a market. It was only 22 miles distant from one of Texas Eastern's major pipeline systems, with which it could be connected at relatively small cost.

[5] The price included 1.3 cents for reimbursement of state taxes. The contracts provided for escalations during future years.

[6] See Natural Gas Act § 7(c), 15 U.S.C. § 717f(c) (1970); *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954).

[7] See Natural Gas Act § 7(a), 15 U.S.C. § 717f(a) (1970); *Ohio Fuel Gas Co.* v. *FPC*, 111 U.S.App.D.C. 337, 296 F.2d 594 (1961).

[8] See text *infra* at note 11.

[9] *Texas Eastern Transmission Corp.*, 21 F.P.C. 869 (1959) (examiner's decision).

[10] *Public Serv. Comm'n* v. *FPC*, 257 F.2d 717 (3d Cir. 1958), *aff'd sub nom. Atlantic Ref. Co.* v. *Public Serv. Comm'n*, 360 U.S. 378 (1959).

mission order granting unconditional certification of gas sales at an initial price lower than the 23.9-cent price involved in the pending applications.[11] The Third Circuit's decisional ground was that the applicants for certification had not discharged their burden of demonstrating that the sale price they proposed was justified in terms of public convenience and necessity.[12]

After that pronouncement, Texas Eastern and the producers renegotiated, and on December 4, 1958, agreed upon another arrangement. Instead of a conventional wellhead sale of the gas at a 23.9-cent price, the new plan provided for sales to Texas Eastern of the producers' leasehold interests in the gas reserves in place.[13] The aggregate sale price was some $134 million,[14] which equated during the

[11] The *CATCO* initial price was 22.4 cents per Mcf, including tax.

[12] *Public Serv. Comm'n* v. *FPC, supra* note 10, 257 F.2d at 722-23.

[13] By that agreement, Texas Eastern acquired the producers' entire working interest in Rayne Field gas, with an exception not here material. Assignment and conveyance of the leasehold interests was expressly made subject to four conditions. See *Texas Eastern Transmission Corp.* (Opinion No. 322), 21 F.P.C. 860, 864 & n.5, 865 & n.6 (1959). For a succinct summary of other salient features of the lease-sale arrangement, see *Atlantic Ref. Co.* v. *Public Serv. Comm'n, supra* note 10, 360 U.S. at 396-97 & n.5.

The lease-sale agreement was made between the producers and Louisiana Gas Corporation, a subsidiary of Texas Eastern incorporated for the purpose of transacting the sale. See *Texas Eastern Transmission Corp.* (Opinion No. 322), *supra* note 13, 21 F.P.C. at 864, 865. The Commission has consistently recognized Texas Eastern as the real party in interest, and has treated the agreement as though Texas Eastern was the direct purchaser thereunder. We do the same.

[14] The exact price was $134,395,700. Of that sum, $12,420,500 was to be paid in cash and the balance in installments spread over a 16-year period ending in 1975, notwithstanding an anticipated lifetime of the field to 1986. After 1975, Texas Eastern would obtain the gas by payment of royalties, severance taxes and operating expenses. Texas Eastern was also required to remit to the producers, until production of some 600 million Mcf of gas, the proceeds of condensate liquids less costs for operating the field.

early years[15] to about 23.5 cents per Mcf for the gas, a figure out of line with prevailing prices.[16] The producers terminated their original contracts with Texas Eastern and withdrew their applications for certification.[17] Texas Eastern moved to amend its certificate application to reflect these developments, and to reopen the administrative hearing.

B. *Opinion No. 322 And Its Demise*

On June 23, 1959, the Commission overruled objections to the new proposal and, in its Opinion No. 322, awarded Texas Eastern an unconditional certificate to build and operate the facilities needed to effectuate the lease-sale.[18] While the Natural Gas Act gave the Commission regulatory authority over the sales of gas which Texas Eastern's original contracts with the producers had contemplated,[19]

[15] The years 1959-67. The equated per-Mcf cost stated in text includes only the $134 million purchase price, and not other costs falling upon Texas Eastern.

[16] The in-line price, see note 44, *infra*, for gas sold under 1958 contracts was 20 cents per Mcf, as the Commission was later to determine. *Texas Eastern Transmission Corp.* (Opinion No. 565), 42 F.P.C. 376, 384 (1968). See also *Texas Eastern Transmission Corp.*, 42 F.P.C. 446, 448-49 (1968) (examiner's initial decision).

[17] Three of the producers did so promptly, and the fourth somewhat later. The producers' theory was that, with a sale of the gas leases rather than the gas itself, Commission approval of the sale, as distinguished from Texas Eastern's proposed construction, was unnecessary. But see text *infra* at notes 22-29.

[18] *Texas Eastern Transmission Corp.* (Opinion No. 322), *supra* note 13. An application by PSC for rehearing was subsequently denied. *Texas Eastern Transmission Corp.*, 22 F.P.C. 451(1959) (order denying rehearing).

[19] Natural Gas Act §§ 4, 5, 15 U.S.C. §§ 717c, 717d (1970). In *Phillips Petroleum Co.* v. *Wisconsin supra* note 6, 347 U.S. at 676-85, the Court held that the Commission had jurisdiction over wellhead sales of natural gas to interstate pipelines for resale in interstate commerce.

the Commission held that it lacked jurisdiction over sales of their gas leases,[20] and that for that reason it was under no obligation to determine, as a precondition to certification of pipeline construction related to those leases, whether the $134 million price was compatible with the public interest.[21] As a result, the producers' gas soon began to flow through Texas Eastern's pipelines for interstate distribution; and over the years ensuing, the flow has continued and the out-of-line prices paid to the producers have, as cost-of-service items, been reflected in the rates Texas Eastern has charged its customers.

Opinion No. 322 was, however, brought to this court for judicial review, and was reversed.[22] Our opinion predated the holding in *United Gas Improvement Company* v. *Continental Oil Company*[23] that the Commission possessed jurisdiction over the sale of the leasehold interests.[24] We stated that while the Commission was empowered to certificate the pipeline construction without passing on the financial merits of the lease-sale arrangement, its order indicated general approval of the terms of that arrangement; and that to the extent that the order purported to do so, it was unsupported by substantial evidence in the

[20] *Texas Eastern Transmission Corp.* (Opinion No. 322), *supra* note 13, 21 F.P.C. at 864. The Commission relied on *FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949), wherein it was held that a transfer of undeveloped leases of gas reserves by an interstate pipeline to a production company fell within the provision of § 1(b) of the Act, 15 U.S.C. § 717b (1970), excluding "the production or gathering of natural gas" from the jurisdiction of the Commission.

[21] *Texas Eastern Transmission Corp.* (Opinion No. 322), *supra* note 13, 21 F.P.C. at 864.

[22] *Public Serv. Comm'n* v. *FPC*, 109 U.S.App.D.C. 289, 287 F.2d 143 (1960).

[23] 381 U.S. 392 (1965).

[24] See text *infra* at note 37.

record.[25] We realized that a determination of the reasonableness of proposed rates is not an express statutory requirement in a proceeding seeking authorization to extend pipeline facilities,[26] but we also recognized that the economic fact of escalating natural gas prices "does make price a consideration of prime importance."[27] We read the Supreme Court's *CATCO* decision "as holding that where a natural gas company seeks an unconditional certificate to make new sales of natural gas at proposed prices which are 'out of line' with existing prices, or which will tend to have an inflationary impact on the natural gas market, it is under an obligation to demonstrate upon the record the reasons why such increased prices are justified by the 'public convenience and necessity.' "[28] And we held that irrespective of whether the parties' lease-sale was beyond the Commission's regulatory jurisdiction, Texas Eastern's pipeline construction and its sales of Rayne Field gas were jurisdictional matters, and the price paid by Texas Eastern to the producers was a factor demanding consideration since Texas Eastern's acquisition costs would become relevant in the regulation of sales by Texas Eastern to its customers.[29] We remanded the case to the Commission with

[25] *Public Serv. Comm'n* v. *FPC, supra* note 22, 109 U.S.App. D.C. at 291, 287 F.2d at 145.

[26] *Id.* See Natural Gas Act § 7, 15 U.S.C. § 717f (1970).

[27] *Public Serv. Comm'n* v. *FPC, supra* note 22, 109 U.S.App.D.C. at 291, 287, F.2d at 145.

[28] *Id.*

[29] *Id.* at 292, 287 F.2d at 146. The producers had "insist[ed] that their gas ha[d] only been committed to Texas Eastern on the basis of the proposed rates and state[d] that, if conditions are attached, consideration will be given to the disposition of the Rayne Field gas in markets not subject to th[e] Commission's jurisdiction." *Texas Eastern Transmission Corp.* (Opinion No. 322), *supra* note 13, 21 F.P.C. at 874. We held that the Commission could not "abdicate its responsibilities simply because the parties tell it that the whole transaction will collapse unless the full price asked is approved." *Public Serv. Comm'n* v. *FPC, supra* note 22, 109 U.S.App.D.C. at 291, 287 F.2d at 145. *Accord, Public Serv. Comm'n* v. *FPC, supra* note 10, 257 F.2d at 722-23.

instructions to either disclaim any approval of the $134 million price or "reopen the record in the certificate proceeding to permit Texas Eastern to establish by adequate evidence that the acquisition costs which it proposes to incur will be consistent with the public convenience and necessity."[30]

C. *Opinion No. 378*

On remand, the Commission took the latter course, and after further hearings, reached two conclusions. On February 6, 1963, in Opinion No. 378,[31] it reversed its earlier position on jurisdiction over the lease-sale and held that it indeed did have jurisdiction.[32] After discovering that power, however, the Commission recognized that the proceeding was not in a posture enabling final disposition. It was essential that the producers, who were not parties to the remanded proceeding, file an application for a certificate of public convenience and necessity for approval of their sale,[33] and the nature of the lease-sale transaction presented novel difficulties in the way of price regulation.[34] The parties were given six months to work out new arrange-

[30] *Public Serv. Comm'n* v. *FPC, supra* note 22, 109 U.S.App.D.C. at 292, 287 F.2d at 146.

[31] *Texas Eastern Transmission Corp.* (Opinion No. 378), 29 F.P.C. 249 (1963).

[32] *Id.* at 252-56.

[33] *Id.* at 256.

[34] *Id.* at 256-57.

ments and submit new filings.[35]

Opinion No. 378 was subjected to judicial review in the Fifth Circuit, and the Commission's jurisdictional determination was reversed.[36] On further review, however, the Supreme Court, limiting its consideration to that question, reversed the Fifth Circuit and sustained the Commission's jurisdiction over the lease-sale.[37] Since no question as to the propriety of the Commission's disposition was before the Court,[38] its action left Opinion No. 378 intact.

D. *Opinion No. 565*

In March, 1966, in response to Opinion No. 378, the producers filed applications for certificates of public convenience and necessity, and another round of hearings ensued. The presiding examiner split his initial decision into two parts, the first dealing with the question of payments to be remitted to producers in the future, and the second, made necessary by the first, with the question of refunds on account of payments to producers in the past. In his Phase I decision, issued January 23, 1968,[39] the examiner

[35] *Id.* at 257, 258. By Opinion No. 378-A, the Commission denied rehearing of Opinion No. 378 *Texas Eastern Transmission Corp.* (Opinion No. 378-A), 30 F.P.C. 153 (1963), with a modification extending the filing period for producers to six months after completion of any judicial review, *id.* at 157.

[36] *Marr* v. *FPC*, 336 F.2d 320 (5th Cir. 1964), *rev'd sub nom. United Gas Improvement Co.* v. *Continental Oil Co., supra* note 23, 381 U.S. 392 (1965).

[37] *United Gas Improvement Co.* v. *Continental Oil Co., supra* note 23. The Court distinguished *FPC* v. *Panhandle Eastern Pipe Line Co., supra* note 20, on the grounds that in the latter the transferred leases were undeveloped, and the transfer was to a production company in contemplation of sales of gas in intrastate commerce. *Id. at* 403-04.

[38] *Id.* at 399.

[39] Reported at 42 F.P.C. 446.

was of the view that the lease-sale did not meet the test of public convenience and necessity because uncertainties as to the volume of gas which would be produced entailed too great a risk for consumers,[40] and because the imbalance in payments during earlier years was not outweighed by countervailing benefits.[41] The examiner recommended modifications of the transaction calculated to render it equivalent to a conventional sale of gas at 20 cents per Mcf after adjustments reflecting costs incurred and benefits obtained by Texas Eastern which normally would have accrued to producers.[42] The examiner's Phase II decision, issued on September 11, 1968,[43] and utilizing an in-line level of 20 cents per Mcf[44] as the basis for computations, recommended that the producers refund to Texas Eastern, and

[40] *Id.* at 451.

In March, 1967, while the applications were pending, Texas Eastern and the producers formalized an agreement obligating the latter to reimburse Texas Eastern at the rate of 20.625 cents per Mcf for any amount beneath 814,339,000 Mcf that their holdings in Rayne Field might fail to produce. This guaranty was deemed insufficient to dispel the uncertainty because reliance on it depended on other assumptions which were equally risky: the ability of producers individually to meet the financial demands in the future; the cost to Texas Eastern of realizing upon it; and the estimates as to production of liquids, the revenues from which would accrue to Texas Eastern and would be unaffected by any deficiency in gas output. *Id.*

[41] *Id.* at 453.

[42] *Id.* at 448-52.

[43] Reported at 42 F.P.C. 455 (examiner's Phase II decision).

[44] The in-line price is the field price in a given time period at which the bulk of proper sales of gas have been made. We have already noted that the in-line price was 20 cents per Mcf when the lease-sale agreement was made. See note 16, *supra*. The examiner recommended that the in-line price be supplanted by just and reasonable prices as they become available. *Id.* at 458, 461, 467. See note 53, *infra*, and accompanying text.

that Texas Eastern in turn refund to its customers, excess collections estimated at $31.5 million through 1967.[45] The examiner further recommended reduction of Texas Eastern's rates.[46]

On August 6, 1969, the Commission issued its Opinion No. 565 and an order upholding in the main the examiner's decision on both phases.[47] The Commission found that the lease-sale arrangement as formulated by the parties did not comport with the public convenience and necessity.[48] Even with a producer guaranty alleviating the possibility of payment for gas that did not exist,[49] the Commission concluded that other uncertainties generated too much risk.[50] Had the lease-sale agreement come before it in an unexecuted form, the Commission declared, it might well have been rejected,[51] but since almost half of the total estimated volume of gas had already flowed through Texas Eastern's pipelines, the Commission decided to modify the transaction in order to put it in its most palatable form.[52] The Commission ordered Texas Eastern to limit further payments to producers to amounts not exceeding a just and reasonable rate of 18.5 cents per Mcf[53] or any such super-

[45] *Id.* at 461, 463, 464.

[46] *Id.* at 466.

[47] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16. The principal difference between the Commission and the examiner related to the amount of producer refunds which Texas Eastern should immediately flow through to its customers. Compare text *supra* at note 45 and *infra* at note 58. See also Part VI, *infra*.

[48] *Id.* at 382-90.

[49] See note 40, *supra*.

[50] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 382-83. See note 40, *supra*.

[51] *Id.* at 383.

[52] *Id.*

[53] After issuance of the examiner's Phase II decision but before rendition of Opinion No. 565, the Commission had set a just and

seding just and reasonable rate as might thereafter be established,[54] and to cease payments when the producers received the full $134 million contract price.[55] The Commission ordered the producers to refund to Texas Eastern the excess, after specified adjustments, of payments received above the 20-cent in-line level prior to October 1, 1968, and thereafter above the 18.5-cent or other applicable just and reasonable rate,[56] a total of $31.5 million through 1967.[57] And the Commission directed Texas Eastern to refund about two-thirds of that amount — $19.9 million through 1967 — to its customers,[58] and to trim its rates to reflect a cost of 18.5 cents,[59] or a cost at any other area rate thereafter becoming applicable.[60]

reasonable rate of 18.5 cents per Mcf for Southern Louisiana gas of the Rayne Field vintage. *Southern Louisiana Area Rate Proceeding* (Opinion No. 546), 40 F.P.C. 530 (1968), *order on rehearing*, 41 F.P.C. 301 (1969), *aff'd sub nom. Austral Oil Co.* v. *FPC*, 428 F.2d 407 (5th Cir.), *cert. denied*, 400 U.S. 950(1970). See text *infra* at notes 69-75.

[54] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 390, 403. The figure derived by application of this formula would be increased by the addition of Texas Eastern's net receipts from sales of liquids after completion of the producer payments, and by the addition of salvage realized by Texas Eastern under certain conditions, and decreased by the amounts of royalties, state taxes and specified development and operating expenses. *Id.* at 403.

[55] *Id.* at 404. Producers would however, receive additionally the amount of any salvage which Texas Eastern might realize from investments made before the final payment. *Id.*

[56] *Id.* at 404-05.

[57] *Id.*

[58] *Id.* at 398-99, 405. The Commission also required Texas Eastern to compute and escrow the amount of customer refunds, *id.* at 405-06, to shape its accounting practices to exclude the producer refunds from its rate base, *id.* at 406-407, and to amend its rates to reflect reductions in costs made possible by Opinion No. 565, *id.*

[59] *Id.* at 401, 407.

[60] *Id.* at 401.

Opinion No. 565 was not a unaminous decision. Commissioners O'Connor and Bagge subscribed to it fully.[61] In all respects save one, they were joined by Chairman White, who dissented solely as to the use of the 20-cent in-line rate partially, instead of the 18.5-cent just and reasonable rate exclusively, as the basis for computation of producer refunds.[62] Commissioners Carver and Brooke expressed the view "for decisional purposes" that the 20- and 18.5-cent refund bases were correct[63] but, on the ground that the lease-sale might yet garner approval, they would have remanded for the development of additional data.[64]

E. *Opinion No. 565-A*

It so happened, however, that Opinion No. 565 and its accompanying order were not effectuated in any meaningful way. Applications for rehearing were presented to the Commission, and by orders entered September 2[65] and 18,[66] 1969, the Commission granted rehearing, and by separate order on the latter date stayed, pending reconsideration, the certificate conditions formulated in Opinion No. 565.[67] On September 29, 1970, the Commission issued Opinion No. 565-A,[68] which purported to reaffirm many of the considerations underlying Opinion 565, but also to substantially modify the solution it presented.

61 *Id.* at 354, 407.

62 *Id.* at 417.

63 *Id.* at 438.

64 *Id.* at 422-23.

65 *Texas Eastern Transmission Corp.* (F.P.C. Sept. 2, 1969) (unreported).

66 *Texas Eastern Transmission Corp.* (F.P.C. Sept. 12, 1969) (unreported).

67 *Texas Eastern Transmission Corp.* 42 F.P.C. 684 (1969) (order granting stay).

68 *Texas Eastern Transmission Corp.* (Opinion No. 565-A), 44 F.P.C. 1079 (1970).

The modifications proposed by Opinion No. 565-A are directly treaceable to significant developments in producer-rate regulation in Southern Louisiana occurring contemporaneously with the proceeding under review. In 1960, the Commission inaugurated a series of proceedings to enable determination of maximum producers' rates for major gas-producing areas and the regulation of such rates on an area-wide basis.[69] Southern Louisiana, in which Rayne Field is situated, was one of those areas. A final order in the Southern Louisiana proceeding — Docket No. AR 61-2 — was issued on September 25, 1968,[70] establishing 18.5 cents per Mcf as the just and reasonable rate for gas of the Rayne Field vintage.[71] On the same date, the Commission commenced a new proceeding — Docket No. AR 69-1 — to determine whether the Southern Louisiana rates set in Docket No. AR 61-2 needed modification in light of later circumstances. In the meantime the Court of Appeals for the Fifth Circuit reviewed and sustained the Commission's order in Docket No. AR 61-2,[72] but petitions for writs of certiorari were presented to the Supreme Court.[73] On applications for rehearing, the Fifth Circuit adhered to its holding, but indicated that despite its affirmance the Commission might have power

69 *Phillips Petroleum Co.*, 24 F.P.C. 537, 547 (1960); Statement of General Policy No. 61-1, 24 F.P.C. 818 (1960). See also *Permian Basin Area Rate cases (Continental Oil Co.* v. *FPC)*, 390 U.S. 747 (1968).

70 *Southern Louisiana Area Rate Proceeding* (Opinion No. 546), *supra* note 53. Docket No. AR 61-2 awaited developments in Docket No. 61-1, related to the Permian basin in Texas. See *Permian Basin Area Rate Cases (Continental Oil Co.* v. *FPC)*, *supra* note 69, 390 U.S. at 458-60.

71 *Southern Louisiana Area Rate Proceeding* (Opinion No. 546), *supra* note 53, 40 F.P.C. at 648.

72 *Austral Oil Co.* v. *FPC, supra* note 53.

73 The petitions were denied, 400 U.S. 950 (1970), but more than two months after Opinion No. 565-A was issued.

to reconsider the order.[74] The Commission then stayed its order in Docket No. AR 61-2 and consolidated that docket with Docket No. 69-1 for further hearing.[75] Thus, when Opinion No. 565-A was handed down, a Commission order establishing just and reasonable rates for Southern Louisiana gas had been affirmed but was pending application for further review, and from the Commission's viewpoint the matter of rates for gas of Rayne Field vintage was still in flux.

Order No. 565-A reflects some shifting of positions among the Commission's members.[76] A majority of the members[77] reaffirmed the basic conclusion that the lease-sale in original form did not serve the public interest.[78] A majority also felt, however, that the modifications imposed by Order No. 565 must undergo some changes.[79] Chairman Nassikas and Commissioner Bagge were of opinion, like Chairman White before them,[80] that the standard for producer refunds to Texas Eastern[81] should be the just and reasonable rate exclusively, rather than the 20-cent in-line rate partially;[82] but, arguing that a

[74] *Austral Oil Co.* v. *FPC*, 444 F.2d 125, 126-27 (5th Cir.), *cert. denied*, 400 U.S. 950 (1970).

[75] *Southern Louisiana Area Rate Proceeding* (Opinion No. 546), *supra* note 53.

[76] Chairman Nassikas and Commissioner Bagge joined positions. *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1080-89. Commissioners Carver and Brooke joined in different positions, but voted with Chairman Nassikas and Commissioner Bagge to enable a disposition. *Id.* at 1098. Commissioner O'Connor stood on his position in Opinion No. 565. *Id.* at 1092. Chairman White had left the Commission.

[77] Chairman Nassikas and Commissioners O'Connor and Bagge.

[78] *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1083-86, 1092.

[79] See text and notes *infra* this part.

[80] See text *supra* at note 62.

[81] See text *supra* at notes 48-57.

[82] *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1084, 1088.

just and reasonable rate had not been finally determined, they voted to defer the question of amount of the refunds.[83] They also were of opinion that Texas Eastern's payments to producers should not be limited to the contract price of $134 million,[84] but should continue until the field was exhausted.[85] These views collided with those expressed in Opinion No. 565 by Commissioner O'Connor,[86] who in Opinion No. 565-A adhered to them.[87] Commissioners Carver and Brooke, the dissenters in Opinion No. 565, would have granted the certificate unconditionally on the ground that the lease-sale met the requirements of public convenience and necessity,[88] but as the next best alternative, concurred in deferment of refunds[89] nd extension of payments to producers for the life of the field.[90]

So it was that the Commission reached no decision as to the refund liability of either Texas Eastern or the producers, and that all issues in that regard were postponed.[91] Thus the provisions of Opinion No. 565 respecting Texas Eastern's prospective payments to producers,[92] the producers' refunds to Texas Eastern,[93] the latter's refunds to customers[94] and its rates for the future,[95] together with the associated escrowing and ac-

[83] *Id.* at 1087-88.

[84] See text *supra* at notes 52-55.

[85] *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1081.

[86] See text *supra* at notes 61-64.

[87] *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1098-1107.

[88] *Id.* at 1097.

[89] *Id.* at 1098.

[90] *Id.*

[91] *Id.* at 1081, 1087-88, 1089, 1097-98.

[92] See text *supra* at notes 53-55.

[93] See text *supra* at notes 56-57.

[94] See text *supra* at note 58.

[95] See text *supra* at notes 59-60.

counting requirements,[96] were all postponed indefinitely pending a new round of hearings.[97] The certificates sought by Texas Eastern and the producers were issued, conditioned upon payment of an adjusted price of 20 cents per Mcf until such time as the area rate might be established.[98]

Petitions seeking rehearing of Opinion No. 565-A were filed,[99] and on November 16, 1970, they were denied,[100] again with shifts in position. Chairman Nassikas and Commissioner Bagge voted for denial without further statement.[101] Commissioner O'Connor voted to deny, but appended a statement arguing that the total to be paid under the lease-sale contract should be adjusted to reflect the time value of money payments to the producers which were delayed by reason of the order requiring refunds.[102] Commissioners Carver and Brooke dissented, and announced withdrawal of their "reluctant concurrence" in Opinion No. 565-A "to the end that the producers can receive" payments "for the life of the field."[103] They reiterated their belief that the lease-sale contract should be approved as originally written.[104] The petitions for review by this court followed.

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[96] See note 58, *supra*.

[97] *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1091.

[98] *Id.* at 1089-90.

[99] The applicants for a rehearing of Opinion No. 565-A were Texas Eastern and three of the four producers. PGW, the intervenor here, submitted an application for rehearing which the Commission rejected as untimely by one day, but accepted it as a motion for reconsideration. *Texas Eastern Transmission Corp.*, *supra* note 100, 44 F.P.C. at 1471 (order denying rehearing). PSC, a petitioner here, did not seek rehearing of Opinion No. 565-A. See note 116, *infra*.

[100] *Texas Eastern Transmission Corp.*, 44 F.P.C. 1471 (1970) (order denying rehearing).

[101] *Id.* at 1471.

[102] *Id.* at 1472.

[103] *Id* at 1474.

[104] *Id.*

II. Status of the Commission's Opinions

The threshold question we confront is the current status of Opinions Nos. 565 and 565-A and the orders respectively accompanying them as exertions of the Commission's adjudicatory authority. No one argues that either of these opinions or orders lacked a Commission majority when they issued. No one suggests that Opinion No. 565-A, when announced, did not effectively modify Opinion No. 565. Rather, the dispute relates to the impact upon the substantive and procedural aspects of those decisions which may have been made by the commmissioners' subsequent votes on the order denying rehearing of Opinion No. 565-A. The votes which Commissioners Carver and Brooke cast on that order are at the center of the controversy.

A. *The Problem and Its Genesis*

Opinion No. 565 and its companion order were supported by the majority votes of Chairman White and Commissioners O'Connor and Bagge in every aspect save one.[105] The one divergence was on the question whether the just and reasonable rate was to be utilized retroactively as well as prospectively as the basis for computing producer refunds to Texas Eastern.[106] On that issue, Chairman White took the affirmative[107] and Commissioners O'Connor and Bagge the negative[108] but they were joined by Commissoners Carver and Brooke "for decisional purposes,"[109] although the latter two dissented for other reasons.[110]

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[105] See text *supra* at notes 61-62.

[106] See text *supra* at note 62.

[107] See text *supra* at note 62.

[108] See text *supra* at notes 56-57, 61.

[109] See text *supra* at note 63.

[110] See text *supra* at note 64.

Similarly, Opinion No. 565-A and the order related to it were sustained, initially at least, by the unqualified votes of Chairman Nassikas and Commissioner Bagge,[111] and by the votes which two of their disagreeing colleagues, Commissioners Carver and Brooke, "reluctantly" contributed to enable the disposition dictated by that opinion and order;[112] only Commissioner O'Connor voted against that disposition.[113] The order denying rehearing of Opinion No. 565-A was backed by a majority consisting of Chairman Nassikas and Commissioners O'Connor and Bagge,[114] with Commissioners Carver and Brooke undertaking to "withdraw [their] reluctant concurrence" in that opinion;[115] and it was the purported withdrawal that bred the first controversy which we consider.

PSC,[116] deeming the withdrawal effective, contends that the majority vote originally effectuating Opinion No. 565-A

[111] See text *supra* at notes 80-85.

[112] See text *supra* at notes 88-90.

[113] See text *supra* at notes 86-87.

[114] See text *supra* at notes 101-02.

[115] See text *supra* at notes 103-04.

[116] PSC sought rehearing of Opinion No. 565 but not Opinion No. 565-A, and on that account Texas Eastern and Continental have moved to dismiss PSC's petition for review to the extent that it complains of the order accompanying Opinion No. 565-A. Texas Eastern contends that Opinion No. 565 was so drastically altered by Opinion No. 565-A that an application for a rehearing of the latter opinion was prerequisite to judicial review. Continental argues additionally that in Opinion No. 565-A the Commission met the objections PSC registered against Opinion No. 565, and that in consequence PSC is no longer aggrieved thereby. For reasons following we deny the motions to dismiss.

Section 19(a) of the Natural Gas Act, 15 U.S.C. § 717r(a) (1970), provides that "[n]o proceeding to review any order of the Commission shall be brought by any person unless such person shall have made application to the Commission for a rehearing thereon." Thus an application for rehearing is a jurisdictional prerequisite to judicial review. *Dayton Power & Light Co.* v. *FPC*,

[Footnote continued on page 25]

in its modification of Opinion No. 565 evaporated with the vote on the order refusing rehearing of Opinion No. 565-A. In other words, PSC claims that when Commissioners

[116] [Continued]
102 U.S.App.D.C. 164, 165, 251 F.2d 875, 876 (1958); *Michigan Consolidated Gas Co.* v. *FPC*, 83 U.S.App.D.C. 395, 167 F.2d 264 (1948); *Pan American Petroleum Corp.* v. *FPC*, 268 F.2d 827 (10th Cir. 1959). Moreover, § 19(b) of the Act provides that "[n]o objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure to do so." See also, *e.g.*, *FPC* v. *Colorado Interstate Gas Co.*, 348 U.S. 492, 497-501 (1955); *Panhandle Eastern Pipe Line Co.* v. *FPC*, 324 U.S. 635, 649 (1945). We find, however, that PSC satisfied these demands.

The obvious purpose of the statutory requirements is to afford the Commission the first opportunity to consider, and perhaps dissipate, issues which are headed for the courts. See *Dayton Power & Light Co.* v. *FPC*, *supra*, 102 U.S.App.D.C. at 165, 251, F.2d at 876; *City of Pittsburgh* v. *FPC*. 99 U.S.App.D.C. 113, 121, 237 F.2d 741, 749 (1956). We have consistently held that our authority to review actions of the Commission is unaffected by events—even irregularities—which do not hamper attainment of that objective. See *Michigan Consolidated Gas Co.* v. *FPC*, 108 U.S.App.D.C. 409, 430-31, 283 F.2d 204, 225-26 (1960); *Dayton Power & Light Co.* v. *FPC*, *supra* 102 U.S.App.D.C. at 165-66, 251 F.2d at 876-77; *City of Pittsburgh* v. *FPC*, *supra*, 99 U.S.App.D.C. at 121, 237 F.2d at 749. Surely a modification of a prior administrative decision on rehearing does not generate a need to request another rehearing where the litigant has already presented his point to the Commission for decision. Here PSC submitted an application for rehearing of Opinion No. 565 on specified grounds, and in Opinion No. 565-A the Commission disdained PSC's positions and denied the application. The grounds which PSC advanced to the Commission match or subsume the contentions PSC now wishes to litigate in this court with respect to both opinions. We cannot say that PSC was obliged to do more before the Commission than it did.

As Continental says, judicial review is reserved by § 19(b), 15 U.S.C. § 717r(a) (1970), to a "party to a proceeding under [the Act] aggrieved by an order issued by the Commission in such proceeding. . . ." But contrary to Continental's assessment, we are satisfied that the effect of Opinion No. 565-A was to intensify rather than ameliorate PSC's complaints as to Opinion No. 565. Put another way, PSC remains "aggrieved"—as much by the one decision as by the other.

Carver and Brooke retracted their joinder in Opinion No. 565-A, that opinion perished and Opinion No. 565 became automatically reinstated. Texas Eastern argues similarly, though more limitedly, that after the loss — because of the withdrawal — of a majority of the commissioners for Opinion No. 565-A, there could no longer be the certificate condition, fashioned in that opinion, converting the responsibility for producer payments from the contract total of $134 million to a liability for continuing payments until cessation of gas production in the transferred leasehold properties.

The Commission, on the other hand, eschewing the withdrawal, asserts that the majority vote for Opinion No. 565-A when issued was unaffected by the subsequent voting with respect to the applications for rehearing of that opinion, and in that position the producers unite. The issue thus boils down to whether the attempted withdrawal charged the 4-1 vote for Opinion No. 565-A and its suspension of the certificate conditions to a vitiating 3-2 vote against Opinion No. 565-A, thus restoring Opinion No. 565 as the final and only decision of the Commission. It is important to resolve the dispute at the outset so that we may know just what we are legitimately called upon to review.

B. *The Governing Principles*

The authority to entertain and dispose of applications for rehearing of Commission orders is defined by the Natural Gas Act. "Upon such application," the Act provides, "the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing."[117] This grant, in terms, runs to the Commission as a governmental body. The Commission is an entity apart

[117] Natural Gas Act § 19, 15 U.S.C. § 717r (1970).

from its members, and it is its institutional decisions — none other — that bear legal significance.[118] Only as an entity can the Commission formulate valid original decisions; by the same token, only in that character can it fashion new decisions remaking those which it has already promulgated.[119] Collective action is prerequisite to any alteration of a preexisting order, whether a grant or denial of rehearing,[120] or a total abrogation or partial modification of that order.[121]

By institutional decisions, we mean, of course, a decision by a majority vote duly taken. That is the rule of the

[118] See *Braniff Airways* v. *CAB*, 126 U.S.App.D.C. 399, 405,06, 410-11, 379 F.2d 453, 459-60, 464-65 (1967). See also *WIBC* v. *FCC*, 104 U.S.App.D.C. 126, 127-28, 259 F.2d 941, 942-43 *(en banc), cert. denied*, 358 U.S. 920 (1958); *Olsen Co.* v. *State Tax Comm'n*, 109 Utah 563, 168 P.2d 324, 328 (1946); *Adkins* v. *Citizens Bd.*, 112 W.Va. 171, 163 S.E. 853 854 (1932).

[119] In *Braniff Airways* v. *CAB*, *supra* note 118, three members of the five-member Civil Aeronautics Board participated in and agreed unanimously upon a decision, but on a motion for reconsideration two of four participating members voted to deny and the remaining two to grant. The two members voting to grant filed a statement which contained findings additional to the earlier findings of the board. We held that the additional findings could not validly supplement or buttress the original findings because

> . . . they were the findings of only two out of four members. Even though these two members were among the three who concurred in the [earlier] decision, we are concerned with reviewing institutional decisions. Despite their personal connection with that opinion the statement of two members of an equally divided regulatory agency possesses no authoritative significance.

126 U.S.App.D.C. at 411, 379 F.2d at 465. See also *Sperry Gyroscope Co.* v. *NLRB*, 129 F.2d 922, 924 (2d Cir. 1942).

[120] See text *supra* at note 117.

[121] See text *supra* at note 117.

common law,[122] which we have hitherto applied to administrative action,[123] and the rule by which, we notice judicially, the Commission has regularly functioned. There being no statutory specification to the contrary, we have no difficulty in accepting it as the governing rule here.[124] And since each of the five members of the Commission[125] cast a vote toward each of the three decisions relevant here, it follows that a concurrence of at least three votes was essential to constitute any given feature of the voting an aspect of commission action.[126] It follows, too, that the efficacy of

[122] *Baltimore & O. R.R.* v. *United States*, 298 U.S. 349, 362 (1936); *Plymouth Coal Co.* v. *Pennsylvania*, 232 U.S. 531, 547 (1914); *ICC* v. *Delaware, L. & W. R.R.*, 220 U.S. 235, 248-51 (1911); *Brown* v. *District of Columbia*, 127 U.S. 579, 586 (1888); *Cooley* v. *O'Connor*, 79 U.S. (12 Wall.) 391, 398 (1871) *Railroad Comm'n* v. *Louisville & N. R.R.*, 140 Ga. 817, 80 S.E. 327, 335-36 (1913); *Codman* v. *Crocker*, 203 Mass. 146, 89 N.E. 177, 180 (1909); *Re State Treasurer's Settlement* (*Bartley* v. *Meserve*), 51 Neb. 116, 70 N.W. 532, 534-36 (1897); *State ex rel. Clausen* v. *Hartley*, 144 Wash. 135, 257 P. 396, 400 (1927).

[123] In *WIBC* v. *FCC*, *supra* note 118, where the votes of six of seven members of the Federal Communications Commission present were equally divided, we rejected the contention that the vote of the seventh commissioner, which broke the tie, was not decisive. 104 U.S.App.D.C. at 128, 259 F.2d at 943. It was argued that since by statute four members of the Commission constituted a quorum, 47 U.S.C. § 154(h) (1970), three votes would control irrespective of the number present and voting. *Id.* at 127-28, 259 F.2d at 942-43. We said that "[w]hen a quorum is present, the . . . Commission may act, but only on the vote of a majority of those present," *id.* at 128, 259 F.2d at 943, and, quoting *Adkins* v. *Citizens Bd.*, *supra* note 118, 163 S.E. at 854, that "[i]t is the common law that where joint authority is involved, a quorum being present, legal action can be taken by a majority and by none less," *id.* We concluded that "when six voted, it took four to control," *id.*, and that when the seventh commissioner voted, "there were seven participants and it still took four to control; hence his vote was decisive," *id.* See also *Greater Boston Television Corp.* v. *FCC*, 143 U.S.App. D.C. 383, 403, 444 F.2d 841, 861 (1970), *cert. denied*, 403 U.S. 923 (1971).

[124] *FTC* v. *Flotill Prods., Inc.*, 389 U.S. 179, 183-85 (1967).

[125] See 16 U.S.C. § 792 (1970).

[126] In this view, we have no occasion to consider whether action of a majority of a quorum of three commissioners, see 16 U.S.C. § 792 (1970), as distinguished from a majority of the full Commission, is prerequisite to the promulgation or modification of an opinion or order. See *FTC* v. *Flotill Prods., Inc.*, *supra* note 124, 389 U.S. at 181-86 & nn. 4, 9, and cases there cited.

action taken by majority vote is in no wise affected by the fact that there is also a minority.[127] "[A] dissent no more reduces the legal effect of [an agency's] findings and order than does a dissenting opinion of a member of a court detract from the legal effect of the court's judgment."[128]

We perceive no incongruity with logic or precedent in these conclusions. On the contrary, neither the requirement of institutional action which Congress has imposed on the Commission nor the principle of majority rule which the Commission has itself impressed upon its decision-making processes could tolerate any other. Collective action, we repeat, is the only authorized means to a decision, including a decision to undo a prior decision. If an agency proceeding could be reopened by the unilateral action of a member who casts a vote for the majority, then, irrespective of the conviction of remaining members that the interest in repose outweighed their doctrinal differences, a single defection from the majority could thwart many a careful considered resolution, and wreak havoc on the stability of the agency's decisions. We have not been referred to nor have we found any authority for such a novel and frightening proposition.

We do not mean to suggest that a commissioner's vote, once made, imprisons him in an intellectual straitjacket. The point is that an individual change of mind cannot change an institutional decision unless it garners a majority vote to do so. Nor is there any requirement, statutory or otherwise, that members of administrative agencies maintain consistent positions throughout the course of lengthy proceedings. Commissioners, no less than judges,[129]

[127] *Sperry Gyroscope Co.* v. *NLRB*, *supra* note 119, 129 F.2d at 924.

[128] *Id.*

[129] Compare *Screws* v. *United States*, 325 U.S. 91, 113, 134 (1945) (concurring opinion of Justice Rutledge).

may cast their votes solely to avoid an impasse,[130] or otherwise to draw the administrative phase to a close. Commissioners Carver and Brooke utilized their votes on Opinion No. 565-A to achieve an objective deemed more important than adherence to personal precept.[131] Commissioner O'Connor voted against rehearing of Opinion No. 565-A despite his differences with that opinion because he felt that the litigation was ripe for judicial review.[132] But, in each instance, what counted in the definition of agency action was the vote rather than the individual view.

In sum, a change of individual position, to affect the institutional decision, must occur as a part of a collective effort directed toward that decision. Once made, the decision remains the decision of the body, immune from alteration save by another collective effort of that body. Individual endeavor to modify an institutional decision, so long as it is only that, is of no consequence in the administrative process.

C. *Application Of Doctrine Here*

The petitions for rehearing of Opinion No. 565-A and its related order[133] presented to the Commission the questions whether the petitions should be granted or denied, and whether the Commission should "abrogate" or "modify" that opinion.[134] The Commission plainly decided those ques-

[130] Compare *Greater Boston Television Corp.* v. *FPC, supra* note 123, 143 U.S.App.D.C. at 403, 444 F.2d at 861.

[131] See text *supra* at notes 88-90.

[132] *Texas Eastern Transmission Corp., supra* note 100, 44 F.P.C. at 1471-73 (order denying rehearing).

[133] These included applications for rehearing by Texas Eastern and the producers and a motion for reconsideration by PGW. PSC did not seek rehearing or reconsideration of Opinion No. 565-A. See notes 99, 116, *supra*.

[134] See text *supra* at note 117.

tions in the negative. The order on rehearing declares the Commission's "opinion" that "the questions raised by the Applicants are sufficiently covered by or are clear from the language of Opinion No. 565-A and order, so that further discussion is unnecessary."[135] The order also sets forth the Commission's finding that "[t]he assignments of error and grounds for rehearing set forth in the applications for rehearing . . . present no facts or legal principles which would warrant any change in or modification of Opinion No. 565-A and " its accompanying order.[136] The sole disposition effected by the order was that "[t]he applications for rehearing . . . [and] the motion for reconsideration . . . are denied."[137]

It is also evident that the Commission's decision to deny rehearing of Order No. 565-A was supported by the votes of a majority of the commissioners. Chairman Nassikas and Commissioner Bagge subscribed fully to the order of denial.[138] Commissioner O'Connor concurred in the denial,[139] and while he filed a statement expressing a change of view as to the amounts which the producers should receive from Texas Eastern,[140] he announced categorically his position that "[t]he granting of rehearing at this time would not serve any constructive purpose,"[141] and that "an additional rehearing would not be fruitful."[142] Only Commissioners Carver and Brooke dissented, adhering to their thesis that the lease-sale transaction should be approved as it was.[143]

[135] *Texas Eastern Transmission Corp., supra* note 100, 44 F.P.C. at 1471 (order denying rehearing).

[136] *Id.*

[137] *Id.*

[138] *Id.*

[139] *Id.* at 1471-73.

[140] *Id.* at 1471.

[141] *Id.* at 1471.

[142] *Id.* at 1472.

[143] *Id.* at 1473-74.

We hold, then, that Opinion No. 565-A was not abrogated or modified by the vote on the petitions to rehear it.[144] Three commissioners — a commission majority — concurred in refusing rehearing of Opinion No. 565-A, and that was the only action which commanded a majority vote. Although the coalitions spawning Opinion No. 565-A were altered by the poll on the petitions for rehearing, the only proposal garnering a majority was the denial of rehearing; and the vote of the majority was, unequivocally, to leave Opinion No. 565-A intact. It bears repeating that the order recited the decision that "[t]he assignments of error and grounds for rehearing set forth" by the applicants for rehearing "present no facts or legal principles which would warrant any change in or modification of Opinion No. 565-A" or the order effectuating it.[145] Hardly could the Commissioners comprising the majority have made plainer their purpose not to change Opinion No. 565-A in any respect whatsoever.

In consequence, the matters before us for review are Opinion No. 565 as modified by Opinion No. 565-A, and Opinion No 565-A without modification, and the orders respectively accompanying those opinions. To the issues tendered for review we now turn.

III. Conventionalization of the Lease-Sale

Opinions Nos. 565 and 565-A each express the finding of a majority of the Commission[146] that the lease-sale

[144] So concluding, we do not reach the question whether an agency opinion or order can be rescinded or amended without a prior vote to reconsider it.

[145] *Texas Eastern Transmission Corp.*, *supra* note 100, 44 F.P.C. at 1471 (order denying rehearing).

[146] As to Opinion No. 565, Chairman White and Commissioners O'Connor and Bagge; as to Opinion No. 565-A, Chairman Nassikas and Commissioners O'Connor and Bagge. See text *supra* at notes 61-62, 78-79, 86-87.

transaction, in the form agreed to by the parties, did not survive the test of public convenience and necessity.[147] For that reason the Commission, in awarding the parties the certificates requested, conventionalized some aspects of the lease-sale to more nearly conform it to a normal gas-sale contract.[148] Both the producers and Texas Eastern contend that the Commission's adverse finding on public interest is insufficiently supported by the evidence, and that the administrative record demonstrates that the lease-sale is more favorable to consumers than a conventional sale could be.

The Commission faced a novel situation in the lease-sale arrangement presented to it, for the lease-sale was not readily amenable to administrative supervision in the Commission's accustomed mode of regulating prices between producers and pipelines.[149] The problems which the lease-sale presented come into sharper focus when the process of certificating conventional sales of gas is first examined.

A. *Certification of Conventional Natural Gas Sales*

A conventional gas-sale contract sets a price for each unit — each Mcf — of gas to be supplied, frequently with a provision escalating the price. When a sale is sought to be certificated, the price is subject to scrutiny by the

[147] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 382-90; *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1083-85.

[148] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 390-93; *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1085-87.

[149] See *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 380; *Texas Eastern Transmission Corp.* (Opinion No. 378-A), *supra* note 35, 30 F.P.C. at 256; *Texas Eastern Transmission Corp.* (Opinion No. 378), *supra* note 31, 29 F.P.C. at 156.

Commission in the exercise of its authority, under Section 7 of the Natural Gas Act,[150] to attach such conditions to the certificate as are necessary in the public interest.[151]

The Supreme Court's decision in *Phillips Petroleum Company* v. *Wisconsin*[152] opened the door to Commission regulation of sales by producers to interstate pipelines, and Sections 4[153] and 5[154] of the Act armed the Commission with general authority to establish just and reasonable rates for the gas sold. But full-fledged rate proceedings are, by their very nature, unsuited to the needs of price review when a producer seeks certification of a sale.[155] Such proceedings are extraordinarily time-consuming,[156] and any relief from excessive rates emanating from those

[150] 15 U.S.C. § 717f (1970).

[151] Natural gas companies must obtain certificates of public convenience and necessity prior to engaging in sales of natural gas subject to the Commission's jurisdiction. Natural Gas Act § 7(c), 15 U.S.C. § 717f(c) (1970). Notice to interested parties and hearing are prerequisite to the issuance of a permanent certificate, but not to the issuance in a case of emergency of a temporary certificate pending application for a permanent certificate. *Id.* Another prerequisite to issuance of a permanent certificate is a finding by the Commission that the sale "is or will be required by the present or future public convenience or necessity," *id.* § 7(e), 15 U.S.C. § 717f(e) (1970), and the Commission may qualify the certificate by "such reasonable terms and conditions as the public convenience and necessity may require." *Id.* See *FPC* v. *Sunray DX Oil Co.*, 391 U.S. 9, 16-19 (1968); *United Gas Improvement Co.* v. *Callery Properties*, 382 U.S. 223, 227-29 (1965); *Atlantic Ref. Co.* v. *Public Serv. Comm'n*, *supra* note 10, 360 U.S. at 391-92.

[152] *Supra* note 6.

[153] 15 U.S.C. § 717c (1970).

[154] 15 U.S.C. § 717d (1970).

[155] See the discussion in *FPC* v. *Sunray DX Oil Co.*, *supra* note 151, 391 U.S. at 16-20; *United Gas Improvement Co.* v. *Callery Properties*, *supra* note 151, 382 U.S. at 227-28; *Atlantic Ref. Co.* v. *Public Serv. Comm'n*, *supra* note 10, 360 U.S. at 388-91.

[156] See *Atlantic Ref. Co.* v. *Public Serv. Comm'n supra* note 10, 360 U.S. at 389-91. See also *FPC* v. *Sunray DX Oil Co.*, *supra* note 151, 391 U.S. at 17-18.

under Section 5 is prospective only.[157] Consumers were thus exposed to irremediable excessive charging while rate-reform proceedings were pending.[158] Even when area rate proceedings came into vogue as the preferred method of setting producer rates,[159] the exigencies of interim price protection remained.[160]

In the *CATCO* litigation,[161] the Supreme Court focused on the problem, emphasizing the vital importance of price regulation under Section 7:

> [T]he inordinate delay presently existing in the processing of § 5 proceedings requires a most careful scrutiny and responsible reaction to initial price proposals of producers under § 7. . . . The fact that prices have leaped from one plateau to the higher levels of another . . . [makes] price a consideration of prime importance. This is the more important during this formative period when the ground rules of producer regulation are being evolved. . . . The Congress, in § 7(e) has authorized the Commission to condition certificates in such manner as the public convenience and necessity may require. Where the proposed price is not in keeping with the public interest because it is out of line or because its approval might result in a triggering of general price rises or an increase in the applicant's existing rates by reason of "favored nation" clauses[162] or otherwise,

[157] *Atlantic Ref. Co.* v. *Public Serv. Comm'n*, *supra* note 10, 360 U.S. at 389. See also *FPC* v. *Sunray DX Oil Co.*, *supra* note 151, 391 U.S. at 17.

[158] *Atlantic Ref. Co.* v. *Public Serv. Comm'n*, *supra* note 10, 360 U.S. at 389. See also *FPC* v. *Sunray DX Oil Co.*, *supra* note 151, 391, U.S. at 17.

[159] See test *supra* at notes 69-75.

[160] *FPC v. Sunray DX Oil Co.*, *supra* note 151, 391 U.S. at 16-19.

[161] Atlantic Ref. Co. v. Public Serv. Comm'n, supra note 10.

[162] "Favored nation" clauses assure producers that they will receive the highest price currently being paid in the same area by their own purchasers or, as it may be provided, by any purchaser. See *FPC* v. *Sunray DX Oil Co.*, *supra* note 151, 391 U.S. at 18 n.2.

> the Commision in the exercise of its discretion might attach such conditions as it believes necessary.[163]

Following *CATCO*, the Commission undertook to assure that the prices at which producer sales were certificated did not exceed in-line prices — the field prices at which the bulk of contemporaneous gas transactions not "suspect" took place.[164] The Supreme Court, in turn, approved the practice as a means of holding the line on prices in the interest of consumer protection until the Commission could determine just and reasonable rates for the gas.[165] This technique streamlined the Section 7 certification process, and the Commission was enabled to certificate sales on the basis of comparative pricing alone, without need to delay the process by indulgence in orthodox rate-making.[166]

The Act spells out the processes by which producer rates set at in-line levels may be altered. After Section 7 certification, a producer may, under Section 4, vie for a higher price by the simple expedient of a 30-day notice to the Commission and the public.[167] The Commission may, however, suspend the proposed increase for a maximum period of five months while it investigates and acts on the

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163 *Atlantic Ref. Co.* v. *Public Serv. Comm'n*, *supra* note 10, 360 U.S. at 391. See also *FPC* v. *Hunt*, 376 U.S. 515 (1964).

164 In ascertaining the in-line price, the Commission and the courts have usually excluded or discounted certain prices which for one reason or another might reflect impermissible price jumps. See *FPC* v. *Sunray DX Oil Co.*, *supra* note 151, 391 U.S. at 19.

165 *Id.* at 21-36. See also *United Gas Improvement Co.* v. *Callery Properties*, *supra* note 151, 382 U.S. at 226-29.

166 *United Gas Improvement Co.* v. *Callery Properties*, *supra* note 151, 382 U.S. at 327-28.

167 Natural Gas Act § 4(d), 15 U.S.C. § 717c(d) (1970). The notice is given by filing with the Commission and keeping open for public inspection new schedules specifying the rate changes and the time they are to go into effect. *Id.*

application.[168] Before it may finally approve the increase, the Commission must find that it does not exceed the just and reasonable rate for gas of its vintage,[169] and the burden of proof on that issue is on the applicant.[170] Pending the outcome of the proceeding, the producer remains under a liability to refund the excess of any increase above the eventual just and reasonable price.[171] And should the Commission see a need to launch its own investigation of a producer's initial rates, it may institute a proceeding for that purpose under Section 5 of the Act.[172]

Case-by-case determination of just and reasonable producer rates on the traditional cost-of-service basis, however, proved to be an intractable process which threatened to inundate the Commission's regulatory function.[173] The solution which the Commission eventually devised was the previously-mentioned scheme of area-wide rate determinations.[174] The scheme won Supreme Court approval in the *Permian Basin Cases*[175] and, in the Court's words, "began a new era in the regulation of natural gas pro-

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168 Natural Gas Act § 4(e), 15 U.S.C. § 717c(e) (1970).

169 *Id.*

170 *Id.*

171 *Id.* But the initial rate established by an unconditional permanent certificate issued under § 7 represents a firm floor below which refunds cannot subsequently be required. *FPC* v. *Sunray DX Oil Co.*, *supra* note 151, 391 U.S. at 23-24. See also *United Gas Improvement Co.* v. *Callery Properties*, *supra* note 151, 382 U.S. at 227. The Court has indicated, however, that the Commission might, as a condition to certification, require the producers to assume liability for refunds measured by the difference between the in-line price and the just and reasonable rate subsequently established should the latter prove to be lower. *FPC* v. *Sunray DX Oil Co.*, *supra* note 151, 391, U.S. at 36-37.

172 15 U.S.C. § 717d (1970).

173 See *Permain Basin Area Rate Cases (Continental Oil Co.* v. *FPC)*, *supra* note 69, 390 U.S. at 755-58.

174 See text *supra* at notes 69-75.

175 *Permian Basin Area Rate Cases (Continental Oil Co.* v. *FPC)*, *supra* note 69.

ducers."[176] The Commission's regulatory effort with respect to Rayne Field, as we have seen, was destined to reach that era.[177]

B. *The Lease-Sale Contrasted*

Upon a conventional gas-sale transaction, then, the rate-making aspect of a Section 7 certification proceeding has as its purpose the fixing of an initial price in line with prices in other jump-free transactions pending the establishment of a just and reasonable rate.[178] The Rayne Field lease-sale transaction, however, could not easily be subjected to the in-line price concept. Although the total price which Texas Eastern was to pay to the producers was fixed by the contract, the eventual volume of gas which the field would produce was necessarily an estimate, and so also any cost per Mcf of the gas which would be extracted. Nonetheless, it was clear that until the late years of production from the producers' holdings in Rayne Field, the price to be paid would exceed the in-line cost of gas actually delivered.[179] Since the purchase price of $134 million was to be remitted in full by 1975 but production was expected to continue until 1986,[180] the parties and the Commission alike were seemingly reconciled to the conclusion that the price of the gas would run considerably higher than the 20-cent in-line price during most of the production period.[181]

Adherence to the Supreme Court's *CATCO*[182] ruling demanded that the Section 7 certification process not develop

[176] *Id.* at 755.

[177] See text *supra* at notes 69-75.

[178] See *Sunray DX Oil Co.* v. *FPC*, *supra* 151, 391 U.S. at 25-26.

[179] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 380.

[180] *Id.* at 379.

[181] *Id.* at 380.

[182] *Atlantic Ref. Co.* v. *Public Serv. Comm'n*, *supra* note 10.

into a protracted affair bogged down in the mire of intricate cost calculation.[183] The in-line price measure was an available index of price trends, and so a ready reference to a price that might shield consumers against exhorbitance.[184] Producers could secure reasonable protection under Section 4 by immediately filing for rate increases, subject to refunds contingent upon the just and reasonable rate ultimately determined.[185] Consumers, on the other hand, got no refund protection under Section 5 against the contingency that the initial price might turn out to be too high.[186] It was against this need to safeguard the interest of consumers that the Commission was summoned to determine whether the lease-sale merited unconditional certification.

C. *The Decision to Conventionalize*

In reviewing action by the Commission within its jurisdiction under the Natural Gas Act, we exercise an "esentially narrow and circumscribed" function.[187] The Act provides unequivocably that "a finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive."[188] And, equally plainly, a Commission ruling on a nonfactual question is to be sustained if there is

[183] 360 U.S. at 389-91, *Accord, FPC* v. *Sunray DX Oil Co., supra* note 151, 391 U.S. at 17-18; *United Gas Improvement Co.* v. *Callery Properties, supra* note 151, 382 U.S. at 227-28.

[184] *FPC* v. *Sunray DX Oil Co., supra* note 151, 391 U.S. at 25-26.

[185] See text *supra* at notes 167-72.

[186] See note 171, *supra*, and accompanying text.

[187] *Permian Basin Area Rate Cases (Continental Oil Co.* v. *FPC), supra* note 69, 390 U.S. at 766.

[188] Natural Gas Act § 19(b), as amended, 15 U.S.C. § 717r(b) (1970).

a rational basis for the conclusion it achieves.[189] It is by these standards that we must test the Commission's decision to condition the certificates of public convenience and necessity awarded Texas Eastern and the producers so as to conventionalize some of the features of the lease-sale.

As early as 1963, when Order No. 378[190] addressed the requests for certification of the lease-sale, it was "clear" to the Commission "from the record in this case that it is not in the public interest for this Commission to certificate a transaction such as the one presented to us on this record."[191] And as the presiding examiner observed in his Phase I decision in 1968, "[t]he reason . . . was that it would be impossible to regulate, or even ascertain, what the producers were getting for the gas or what the cost to the pipeline would be."[192] For, in the beginning, a major unknowable was the volume of gas which the transferred reserves would ultimately yield, and consequently the eventual unit price which Texas Eastern would pay for the yield.[193]

After Opinion No. 378 was announced, the producers sought to eliminate the risk of possible overestimation of the reserves by guaranteeing that they would supply Texas

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189 *Atlantic Ref. Co.* v. *FTC*, 381 U.S. 357, 367 (1965); *Gilbertville Trucking Co.* v. *United States*, 371 U.S. 115, 126 (1962); *Rochester Tel. Corp.* v. *United States*, 307 U.S. 125, 146 (1939); *Mississippi Valley Barge Line Co.* v *United States*, 292 U.S. 282, 286-87 (1934); *Brotherhood of Ry. Clerks, Freight Handlers, Express & Station Employees* v. *Railroad Retirement Bd.*, 99 U.S.App.D.C. 217, 224, 239 F.2d 37, 44 (1966); *American Airlines* v. *CAB*, 97 U.S.App.D.C. 324, 327, 231 F.2d 483, 486 (1956); *Namekagon Hydro Co.* v. *FPC*, 216 F.2d 509, 512 (7th Cir. 1954).

190 *Texas Eastern Transmission Corp.* (Opinion No. 378), *supra* note 31.

191 29 F.P.C. at 256.

192 *Texas Eastern Transmission Corp.*, *supra* note 16, 42 F.P.C. at 447 (examiner's decision).

193 *Texas Eastern Transmission Corp.* (Opinion No. 378), *supra* note 31, 29 F.P.C. at 256-57.

Eastern with a designated minimum volume of gas.[194] With this single change in the transaction, the parties again presented the lease-sale to the Commission with requests for unconditional certification.[195] The examiner decided that certification should be accompanied by an imposition of conditions,[196] and the Commission adopted and has consistently adhered to that position.[197]

Like the examiner, the Commission in Opinion No. 565 was of the view that the reserve guaranty did not reduce much of the cost-price hazard inherent in the lease-sale.[198] "[T]here are," the Commission said, "numerous other factors which can have a substantial impact upon the cost of the gas to Texas Eastern and its customers under the lease-sale, such as the value and quantity of the liquids, the rate of production of the gas and liquids, the rate of return Texas Eastern is entitled to throughout the life of the wells, and associated taxes, variations in operating expenses and uncertainty of delivery."[199] So great was the peril that the Commission felt that were the lease-sale still executory, it might well reject it.[200]

When, however, the Commission came in Opinion No. 565 to again consider the lease-sale on its merits, it had long since ceased to be entirely executory. By the end of

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194 See note 40, *supra*.

195 *Texas Eastern Transmission Corp.*, *supra* note 16, 42 F.P.C. at 447 (examiner's decision).

196 *Id.* at 447-53.

197 *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 382-90; *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1083-85; *Texas Eastern Transmission Corp.*, *supra* note 100 (order denying rehearing).

198 *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 383.

199 *Id.*

200 *Id.*

1968, almost half of the estimated recoverable gas had been taken, and most of the contract price had been paid to the producers.[201] In this milieu, the Commission deemed it "appropriate to compare the estimated cost of the lease-sale as a whole to Texas Eastern and its customers with the cost of a conventional gas purchase arrangement."[202] The Commission admonished that "[i]n making this comparison, however, we must keep in mind the continuing substantial uncertainties as to the lease-sale arrangement and could only find it is required by public convenience and necessity, as contrasted with a conventionalized sale, if the comparison were significantly in its favor."[203] And on scrutiny the Commission found that "the comparison is not favorable to the lease-sale, even without considering the uncertainties thereof."[204]

Opinion No. 565, as we read it, predicated that finding on two bases. One was a cost comparison of the lease-sale with a conventional gas-sale, which disclosed a difference of some $6 million in favor of the latter.[205] To the purchase price of $134,395,700 the Commission added Texas Eastern's other net Rayne Field costs and, using the producers' estimates of gas and liquid takes, computed a total cost to Texas Eastern of $168,900,000 over the expected life of the reserves.[206] On the other hand, the Commission ascertained that a conventional sale of the gas priced at 20 cents per Mcf from the start of the flow until October 1, 1968,[207] and at 18.5 cents thereafter,

[201] *Id.*
[202] *Id.*
[203] *Id.*
[204] *Id.*
[205] *Id.* at 387.
[206] *Id.*
[207] This was the effective date of the Commission's decision in the *Southern Louisiana Area Rate Proceeding* (Opinion No. 546), *supra* note 53.

would cost Texas Eastern a total of $186,537,000.[208] But when these two totals were discounted at 5 percent for the time value of Texas Eastern's advances to the producers, the Commission learned that the effective cost was $122,403,000 under the lease-sale and $116,270,000 by a conventional approach.[209] As the Commission noted, the difference would be greater if a discount rate of 6 percent were employed.[210]

This difference in cost was not, however, the only consideration motivating the Commission to disapprove the lease-sale as presented. A second factor which loomed large was the Commission's belief that despite the reserve guaranty, the lease-sale was fraught with uncertainties which precluded a confident evaluation of its economic impact, and that the public interest would hardly be served by thrusting the risk of an excessive price on consumers. Opinion No. 565 set forth a summary of the uncertainties, to which we have adverted,[211] and the Commission's overall conclusion:

> [T]he lease-sale arrangement produces a lack of certainty over the life of the field and, as the record indicates, a higher cost than a conventional sale at 20 cents per Mcf. Because of these features of the lease-sale transaction, it is imperative for the Commission to take steps within its jurisdiction, which will protect consumers from paying excessive rates. This can be done, we believe effectively, through regulating the payments made by Texas Eastern to the Producers by conditioning the lease-sale arrangement.[212]

[208] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 387.
[209] *Id.*
[210] *Id.*
[211] See text *supra* at notes 190-200.
[212] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 389.

The uncertainty factor reappeared as a topic of discussion in Opinion No. 565-A. The producers contended that uncertainty is an element in many projects submitted for Commission approval, and that the uncertainties remaining in the lease-sale transaction after the reserve guaranty was made, did not exceed reasonable bounds. The Commission disagreed, responding:

> While, of course, there is always uncertainty, more is involved here, for the proposal is to commit Texas Eastern to a fixed price of $134,395,000 for the life of the field, and that is not true in the conventional certificate proceeding where the price is subject to regulation. The essence of our objection to the lease-sale transaction is its inflexibility. If the price turns out to be too high in the light of changing circumstances, it fails to protect the consumers; if it is too low the producers will not receive an adequate return and this, in turn, may affect their ability to serve the market.[213]

Before the Commission the producers also argued, as they have here, that the advantageous features of the lease-sale demanded consideration conjunctively with cost data in determining whether it was that arrangement or a conventionally-converted sale that best served the public convenience and necessity.[214] We agree that the price of

[213] *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1083.

[214] The producers also contend that one of the modifications effected by Opinion No. 565-A so undermined one of the assumptions underlying the decision in Opinion No. 565 to conventionalize as to leave it without sufficient evidentiary support. As we have seen, one of the factors contributing to that conclusion in Opinion No. 565 was the Commission's finding that the lease-sale would ultimately involve a cost of some $6 million more than a conventional sale of the Rayne Field gas. See text *supra* at notes 205-10. In so finding, the Commission calculated gas costs at the in-line price of 20 cents per Mcf to October 1, 1968, and at the just and reasonable rate of 18.5 cents thereafter. See text *supra* at notes 207-

the Rayne Field gas was not the only relevant criterion, and that the Commission was required "to evaluate all factors bearing on the public interest,"[215] but we cannot agree that the Commission was derelict in that duty. On the contrary, the Commission, in both of its opinions on the subject of conventionalization,[216] addressed the non-cost factors which the producers advanced and found them insufficient to warrant unconditional approval of the lease-sale.[217] In addition to the reserve guaranty,[218] the pro-

08. In Opinion No. 565-A, however, the Commission held that producer refunds should be computed from the beginning on the basis of the just and reasonable rate to be established in the ongoing investigation in the Southern Louisiana area. See text *supra* at notes 80-83. The producers argue that this change of position upset the earlier position on conventionalization. We think it does not.

The higher cost of lease-sale gas which the Commission found in Opinion No. 565 was not the only reason for the Commission's refusal to unconditionally certificate the arrangement; another was the grave uncertainty as to just what the gas would eventually cost under that arrangement. See text *supra* at notes 211-13. Whatever may be said as to the effect on Opinion No. 565 of the refund-base change made in Opinion No. 565-A, it is clear that the Commission had no intention of altering its decision on conventionalization. Opinion No. 565-A not only confirms the Commission's resolve in Opinion No. 565 to conventionalize, but also modified Opinion No. 565 in several particulars "so as to bring it closer to a conventional sale." *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1081. We have no warrant to set aside a Commission determination simply on the thesis that it rests on one valid ground instead of two.

[215] *Atlantic Ref. Co.* v. *Public Serv. Comm'n*, *supra* note 10, 360 U.S. at 391.

[216] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 382-90; *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1083-85.

[217] In so concluding, the Commission discounted testimony by three witnesses offered by the producers in an attempt to demonstrate financial advantages for the lease-sale. *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 388; *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1084-85. The Commission pointed out that one of the witnesses failed to take into account about $18 million in severance taxes which Texas Eastern would pay over life of the

ducers pointed out that Texas Eastern and its customers obtained a large supply of gas in a single package close by its pipeline, with resultant savings in gathering and transportation costs. The Commission felt that that did not make for a unique situation, since large and well located reserves are features of many conventional sale transactions.[219] The producers pointed to the further fact that Texas Eastern secured the Rayne Field gas at a firm price, and to the potential saving from the absence of price escalations; but, as the Commission responded, the price was in any event subject to the Southern Louisiana area rate.[220] The producers also called attention to the flexibility of operations — another cost saver — which Texas Eastern gained under the lease-sale arrangement. As the Commission responded, however, Texas Eastern was taking the gas at a normal rate, and would be required to continue to do so is the future.[221] "These factors," said

field, *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 388; that another failed to take into account the time value of Texas Eastern's advance payments to producers, *id.;* and that the third omitted that factor and other costs to Texas Eastern as well, *id.; Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1085. In these circumstances, we have no occasion to disturb the Commission's action in that respect.

218 As we have stated, the Commission in Opinion No. 565 concluded that the reserve guaranty, standing alone, did not eliminate the objectionable uncertainty in the lease-sale arrangement. See text *supra* at notes 194-200. And in Opinion No. 565-A, the Commission expressed the view that the guaranty "should not be considered of much weight for it guarantees the amount of the reserves, but not the rate at which the gas may be taken and therefore takes no account of the time value of money." *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1084.

219 *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 389.

220 *Id.; Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1084.

221 *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 389. See note 241, *infra*. And in *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C.

the Commission, "do not justify the price of gas to Texas Eastern under the contract which may be excessive even on the basis of the entire life of the field."[222]

When this litigation was previously before this court, we extended to the Commission the option to "reopen the record in the certificate proceeding to permit Texas Eastern to establish by adequate evidence that the acquisition costs which it proposes to incur will be consistent with the public convenience and necessity."[223] And when the Commission elected to do so and properly asserted jurisdiction over the lease-sale,[224] it concluded that the public interest would be ill-served by certification of a transaction in which the unit cost of the involved gas could not be accurately determined.[225] Conventionalization of the lease-sale developed for the Commission as the appropriate, and we think as a rational, method of enabling the Commission to discharge its statutory responsibilities.

In reviewing the Commission's decision to conventionalize, we have remained advertent to the difficulty of the problem which it faced and to the appeal which some of the parties' arguments had for a minority of its members.[226] Those arguments, in large measure, have been

at 1083-84, the Commission stated that "[i]t is impossible on this record, and it would be extremely difficult on any record, to appraise the advantage to Texas Eastern of large daily swings," and that in any event that opinion would require a take at a lower level and limits on downward swings. Compare *Phillips Petroleum Co.* v. *FPC*, 405 F.2d 6, 9-10 (10th Cir. 1969).

222 See *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 389-90 (footnote omitted).

223 See text *supra* at note 30.

224 See text *supra* at notes 31-35.

225 See text *supra* at notes 194-200.

226 *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 435-38, 439-40; *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1097-99, 1102-09; *Texas Eastern Transmission Corp., supra* note 100, 44 F.P.C. at 1473-74 (order denying rehearing).

repeated here in a forceful effort to persuade us to a result opposite to that thrice reached by a Commission majority.[227] But "Congress has entrusted the regulation of the natural gas industry to the informed judgment of the Commission, and not to the preferences of reviewing courts."[228] And "[a] presumption of validity . . . attaches to each exercise of the Commission's expertise, and those who would overturn the Commission's judgment undertake 'the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences.'"[229] We have witnessed ample support in the evidence for the Commission's factual findings,[230] and ample support in reason for its non-factual conclusions.[231] We hold that the Commission's action on this branch of the litigation must stand.

IV. Sale Price of the Gas

A. *The Price Adjustments*

In Opinion No. 565, the Commission effectuated its decision to equate the lease-sale to a conventional gas sale by attaching to the certificates of public convenience and

[227] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 382-90; *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1083-84; *Texas Eastern Transmission Corp., supra* note 100, 44 F.P.C. at 1471 (order denying rehearing).

[228] *Permian Basin Area Rate Cases* (*Continental Oil Co.* v. *FPC*), *supra* note 69, 390 U.S. at 767. For the same reason, we put aside the suggestion of Commissioners Carver and Brooke that "[i]f the Court of Appeals decided [that the lease-sale] must be rewritten in some fashion, it may tell us how it believes it should be done." *Texas Eastern Transmission Corp., supra* note 100, 44 F.P.C. at 1474 (order denying rehearing).

[229] *Permian Basin Area Rate Cases* (*Continental Oil Co.* v. *FPC*), *supra* note 69, 390 U.S. at 767, quoting *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944).

[230] See text *supra* at notes 198-225.

[231] See text *supra* at notes 198-225.

necessity which it awarded a set of conditions designed to achieve that end.[232] The Commission's central effort in the formulation of the conditions, as it would have been had the gas been conventionally sold, was the setting of an initial unit price which would serve the public interest until such time as a just and reasonable rate might be established.[233] The conditions we consider now are those which concern pricing. We will have occasion to examine others later.

Utilizing as a base price the area rate of 18.5 cents per Mcf effective October 1, 1968,[234] which was to remain subject to change in any future area rate proceeding,[235] the Commission subtracted the costs assumed by Texas Eastern which normally are borne by producers and added the economic advantages which normally accrue to producers.[236] Since under the lease-sale arrangement Texas Eastern was paying royalties and state taxes, and was making capital investments and incurring expenses in developing and operating the field,[237] the Commission directed that these outlays be deducted from the 18.5 cent unit price.[238] These adjustments, the Commission ordained, would continue in effect until Texas Eastern paid the $134 million purchase price in full.[239] On the other hand, since producers

[232] *Texas Eastern Transmission Corp* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 390-407.

[233] *Id.* at 390-93.

[234] See text *supra* at notes 69-75.

[235] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 390.

[236] *Id.* at 390-93.

[237] *Id* at 390. The lease-sale contract provided that until 613,406,700 Mcfs of gas were produced, revenues from liquids would be used to reimburse Texas Eastern for part of the production investments and expenses. The reduction of the 18.5 cent price on account of these items was accordingly limited to the amount of unreimbursed investments and expenses. *Id.*

[238] *Id.*

[239] This aspect of the matter will shortly be addressed extensively.

selling gas conventionally ordinarily realize the benefit of liquid revenues and salvage, which under the lease-sale contract inured to Texas Eastern, the Commission specified that after payment of the purchase price the 18.5 cent price would be increased by those items.[240] The Commission also imposed conditions calculated to afford the producers protections which they would have enjoyed under a conventional arrangement.[241]

In conventionalizing the lease-sale, the Commission felt it unnecessary to reject all of its features, some of which the Commission felt had tax advantages for the contracting parties.[242] One of the features retainable, the Commission held, was the $134 million price specified in the lease-sale contract as the total of the consideration to be paid to the producers by Texas Eastern. The Commission proposed, in that connection, to "require that the payments to be made by Texas Eastern for the Rayne Field gas until the purchase price of $134,395,700 has been paid be the equivalent of a purchase of gas under a conventional contract."[243] The Commission elucidated:

[240] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 390-91.

[241] These included a requirement that Texas Eastern remove the gas at a specified minimum pace over a 20-year maximum period, *id.* at 391; and a provision giving the producers the right of prior approval of Texas Eastern's expenditures for royalties and developmental expenses, *id.* at 392.

[242] *Id.* at 389. So, in addition to the total price ceiling soon to be discussed, the Commission decided not to amend the notes evidencing the unpaid installments of purchase price, and observed that any change as to them should be made by the parties or other holders. *Id.* at 391. The Commission also declined to make provision for periodic price increases, reimbursement for new taxes, take-or-pay or the buyer's bearing cost of compression, stating "that if the Producers for their own purposes including possible tax advantages, entered into a lease-sale arrangement, they are not entitled to claim the benefit of provisions found in a conventional sale." *Id.* at 393.

[243] *Id.* at 390.

> [W]e shall adjust the arrangement so that, up until the entire purchase price of $134,395,700 is paid by Texas Eastern, it will be equivalent in economic effect to a conventional sale at the just and reasonable price of 18.5 cents per Mcf. After that, as proposed by the Applicants, Texas Eastern would make no further payments, for if we required continued payments until the Field was exhausted the lease-sale would be, in effect, converted into a conventional sale, presumably with the corresponding tax consequences. To accomplish these ends will clearly involve a reduction of the payments for gas and an extension of the paying period, but the Producers would eventually receive the full purchase price of $134,395,700, although over a longer period, even after making the refunds which [Opinion No. 565 directed].[244]

And the Commission further explained:

> After the end of the production payment until the entire purchase price is paid, the price should continue to be reduced by royalties, state taxes, investments and expenses, but should be increased by liquid revenues and salvage, for the Producers in a conventional sale would receive the benefit of both of these items.
>
> Eventually, even though the payments are reduced, as long as gas continues to flow from the Rayne Field, Texas Eastern will pay the full purchase price of $134,395,700 albeit over a longer period of time. In our opinion the Producers, providing there is sufficient gas, should receive the full amount for which they contracted even though they have been required to make a refund for the period prior to this order. After the full payment as been completed Texas Eastern will pay the Producers no more for gas taken from the Rayne Field. Since it will then have fully paid for the properties transferred, Texas Eastern, alone, should bear the cost of the royalties, state taxes and costs of operating the

[244] *Id.* at 389.

> Field, but it should receive the benefit of all liquid revenues. Texas Eastern, however, should pay the Producers for any salvage realized on property installed before the purchase price has been fully paid, since the cost of such property under the opinion and order will be deducted from the price of gas of 18.5 cents per Mcf. Of course, salvage realized from property installed after the payments have been completed and not charged against the Producers should benefit Texas Eastern.[245]

In Opinion No. 565-A, however, the Commission changed its treatment of the purchase price completely. The producers had contended that Opinion No. 565, in partially conventionalizing the lease-sale, had unfairly and confiscatorily placed burdens on them without conferring the benefits of a conventional sale.[246] Attention was directed particularly to the provision that after Texas Eastern paid the $134 million contract price, it would get any additional gas and liquids free of charge.[247] Attention was also called to the fact that while under the lease-sale agreement the entire purchase price would be remitted during the first 16 years of production, Opinion No. 565 enlarged the payment period to the extent required to absorb the $134 million at the adjusted 18.5 cent rate.[248]

The Commission was persuaded by these arguments. In Opinion No. 565-A, it declared that "while the Producers, under the arrangement we prescribed, [in Opinion No. 565] will be getting the contract price it will not be of the same value because they will receive it over a much longer period, and they will not receive the benefit of all the gas and liquids produced by the Field as they would under a conventional

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[245] *Id.* at 390-91 (footnote omitted).

[246] *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1085.

[247] *Id.*

[248] *Id.*

contract."[249] In these circumstances, the Commission felt "that it is only equitable that they be paid for the gas and receive credit for the liquids produced until the Field is exhausted."[250] The Commission added:

> Texas Eastern will retain the leases conveyed to it, and will continue to be responsible for operating expenses and necessary investments.
>
> This means that the conditions prescribed in this Opinion and order with respect to future pricing of the gas from the Rayne Field will be extended until the exhaustion of the field. Thus Texas Eastern shall pay the Producers the appropriate area rate for the gas produced less royalties, state taxes and investments and expenses for the development and operation of the Field. Under the lease-sale arrangement before the termination of the production payments revenues from liquids are used to reimburse Texas Eastern. Therefore, the area price should be reduced only by unreimbursed investments and expenses, and, after the termination of the production payment, the price should be increased by the liquid revenues.[251]

This modification of Opinion No. 565 was supported in Opinion No. 565-A by four of the five members of the Commission,[252] and when rehearing of Opinion No. 565-A was sought, the Commission adhered to that position.[253]

The Commission's reversal of position as to the continuing efficacy of the $134 million contract price as a ceiling on Texas Eastern's payments to the producers for Rayne Field gas engendered an issue which is hotly contested in this court. Texas Eastern argues that the condi-

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[249] *Id.*

[250] *Id.*

[251] *Id.* at 1085-86.

[252] Chairman Nassikas and Commissioners Bagge, Carver and Brooke, *Id.* at 1081, 1098.

[253] *Texas Eastern Transmission Corp., supra* note 100, 44 F.P.C. at 1471 (order denying rehearing).

tion extending its payments over the life of the field will compel an expenditure of many millions of dollars over the maximum price agreed to by the producers, and that the Commission exceeded its authority in imposing that requirement. The producers and the Commission, with equal vigor, defend the requirement as a lawful and appropriate exercise of regulatory power under Section 7 to condition certificates of public convenience and necessity. Our starting point will be a comprehensive analysis of the Natural Gas Act in its relation to the Commission's authority to alter contract prices to which the parties have voluntarily subscribed.[254] The remaining point we will consider is the Commission's power to effect the alteration of which Texas Eastern complains.[255]

B. *The Power to Change Contract Prices*

Two decisions of the Supreme Court, read conjunctively, make it crystal clear that the Commission possesses only limited power to raise prices for natural gas above those contractually fixed by the parties. In *United Gas Pipe Line Company* v. *Mobile Gas Service Corporation*,[256] a regulated pipeline supplying natural gas to a distributor filed with the Commission a new rate schedule purporting to increase the price of its gas above that specified in its contract with the distributor. The Commission rejected the latter's complaint but, on review, the Court held that the Act did not empower the pipeline to unilaterally change the contract rate.[257] The Act, the Court stated, "evinces no purpose to abrogate private rate contracts. To the contrary, by requiring contracts to be filed with the Commission,[258] the Act expressly recognizes that rates to particular customers may be set by individual contracts."[259] Rejecting the contention that Section 4(d) and (e)[260] and 5(a)[261] are alternative rate-changing procedures, the Court said:

> These sections are simply parts of a single statutory scheme under which all rates are established initially by the natural gas companies, by contract or otherwise, and all rates are subject to being modified by the Commission upon a finding that they are unlawful. The Act merely defines the review powers of the Commission and imposes such duties on natural gas companies as are necessary to effectuate those powers; it purports neither to grant nor to define the initial rate-setting powers of natural gas companies.[262]

Section 5(a), authorizing the Commission to set aside or modify any rate found to be "unjust, unreasonable, unduly discriminatory, or preferential[,]" the Court continued, "is neither a 'rate-making' nor a 'rate-changing' procedure. It is simply the power to review rates and contracts made in the first instance by natural gas companies and, if they are determined to be unlawful, to remedy them."[263] And since the Act does not define the power of natural gas companies either to make or change rates and contracts,[264] "[t]he obvious implication is that, except as specifically limited by the Act, the rate-making powers of natural gas companies were to be no different from those they would process in the absence of the Act: to establish *ex parte,* and change at will, the rates offered to prospective customers; or to fix by contract, and change only by

254 Part IV (B), *infra.*
255 Part IV (C), *infra.*
256 350 U.S. 332 (1956).
257 *Id.* at 344.
258 See Natural Gas Act § 4 (d), 15 U.S.C. § 717c(d) (1970).

259 *United Gas Pipe Line Co.* v. *Mobile Gas Serv. Corp., supra* note 256, 350 U.S. at 338.
260 15 U.S.C. § 717c(d) and (e) (1970).
261 15 U.S.C. § 717d(a) (1970).
262 *United Gas Pipe Line Co.* v. *Mobile Gas Serv. Corp., supra* note 256, 350 U.S. at 341.
263 *Id.*
264 *Id.* at 343.

mutual agreement, the rate agreed upon with a particular customer."[265] So, the Court concluded, "there is nothing in the structure or purpose of the Act from which we can infer the right, not otherwise possessed and nowhere expressly given by the Act, of natural gas companies unilaterally to change their contracts."[266]

In *Mobile,* the Court also noted, however, "that this interpretation, while precluding natural gas companies from unilaterally changing their contracts simply because it is in their private interests to do so, does not deprive them of an avenue of relief when their interests coincide with the public interest." [267] The Court explained:

> Section 5(a) authorizes the Commission to investigate rates not only "upon complaint of any State, municipality, State commission, or gas distributing company" but also "upon its own motion." Thus, while natural gas companies are understandably not given the same explicit standing to complain of their own contracts as are those who represent the public interest or those who might be discriminated against, there is nothing to prevent them from furnishing to the Commission any relevant information and requesting it to initiate an investigation on its own motion. And if the Commission, after hearing, determines the contract rate to be so low as to conflict with the public interest, it may under § 5(a) authorize the natural gas company to file a schedule increasing the rate.[268]

[265] *Id.* (emphasis in original).

[266] *Id.* at 343-44.

[267] *Id.* at 344.

[268] *Id.* at 344-45 (footnote omitted). Compare, however, *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Div.,* 358 U.S. 103 (1958), where a pipeline's service agreements with distributors were construed as fixing, not a single specified rate, but rather the going rate as periodically established through proceedings under the Act, with the result that *Mobile* was inapplicable to an increase effected unilaterally by the pipeline's filing of new rate schedules under § 4(d), subject to commission review under § 4(e). There the pipeline sought "simply to assert, in accordance with the procedure specified by the Act, rights expressly reserved to it by contract.' *Id.* at 112.

On the same day *Mobile* was decided, the Court announced its opinion in *Federal Power Commission* v. *Sierra Pacific Power Company.*[269] The question there was whether the Commission could increase the rate specified in a contract by which an electric utility agreed to supply power to a distributor. The Commission allowed the increase solely on the ground that the contract rate yielded less than a fair return on the utility's net invested capital.[270] The asserted basis for the increase was Section 206(a) of the Federal Power Act[271] which, similarly to Section 5 of the Natural Gas Act, authorizes the Commission to fix the just reasonable rate for electricity if the existing rate is "unjust, unreasonable, unduly discriminatory, or preferential."[272] The Court pointed out that "while it may be that the Commission may not normally *impose* upon a public utility a rate which would produce less than a fair return, it does not follow that the public utility may not itself agree by contract to a rate affording less than a fair return or that, if it does so, it is entitled to be relieved of its improvident bargain."[273] "In such circumstances," said the Court, "the sole concern of the Commission would seem to be whether the rate is so low as to adversely affect the public interest — as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory."[274] Observing that "the purpose of the power given the Commission by § 206(a) is the protection of the public interest, as distinguished from the private

[269] 350 U.S. 348 (1956).

[270] *Id.* at 354-55.

[271] 16 U.S.C. § 824e (1970).

[272] *FPC* v. *Sierra Pac. Power Co., supra* note 269, 350 U.S. at 353.

[273] *Id.* at 355 (emphasis in original).

[274] *Id.*

interests of the utilities,"[275] the Court deemed it "clear that a contract may not be said to be either 'unjust' or 'unreasonable' simply because it is unprofitable to the public utility."[276]

These decisions furnish the standard by which the administrative action under scrutiny must be gauged. In recent years, the Supreme Court has applied them to uphold the Commission's refusal to fix minimum area rates for producers at levels above their contract prices.[277] "The regulatory system created by the Act," the Court declared, "contemplates abrogation of these agreements only in circumstances of unequivocal public necessity."[278] We ourselves have applied the *Mobile-Sierra* doctrine,[279] and the Commission has relied on it to justify its refusal to override Southern Louisiana producers' contract prices with higher minimum area rates.[280]

C. *The Purchase Price Adjustment*

The plan by which the Commission conventionalized the lease-sale arrangement involved contractual deviations of three major types. The first was the substitution of an

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[275] *Id.*

[276] *Id.*

[277] *Permian Basin Area Rate Cases* (*Continental Oil Co.* v. *FPC*), *supra* note 69, 390 U.S. at 820-22.

[278] "The regulatory system created by the Act is premised on contractual agreements voluntarily devised by the regulated companies; it contemplates abrogation of these agreements only in circumstances of unequivocal public necessity." *Id.* at 822 (citation omitted).

[279] See *Portsmouth Gas Co.* v. *FPC*, 101 U.S.App.D.C. 99, 102-03, 247 F.2d 90, 93-94 (1957); *Cincinnati Gas and Elec. Co.* v. *FPC*, 101 U.S.App.D.C. 1, 6, 246 F.2d 688, 693 (1957). See also *Richmond Power & Light* v. *FPC*, —— U.S.App.D.C .——, 481 F.2d 490, *cert. denied, sub nom. Indiana & Michigan Elec. Co.* v. *Anderson Power & Light Co.*, 42 U.S.L.W. 3334 (U.S. Dec. 4, 1973).

[280] *Southern Louisiana Area Rate Proceeding* (Opinion No. 546), *supra* note 53, 40 F.P.C. at 624.

initial unit price for the original price which the parties had fixed at the lump-sum figure of $134,395,700.[281] The second consisted in a series of requirements, to which the parties had not themselves previously agreed, which implemented the unification of the initial price.[282] The third was the elimination, in Opinion No. 565-A, of the $134 million contract price as the amount to be remitted to the producers by Texas Eastern, and the direction that Texas Eastern pay a to-be-established just and reasonable area rate for all gas realized from the beginning to the end of production.[283] As is evident, each of these changes portended a problem in terms of the *Mobile-Sierra* doctrine.[284]

— The Unit Price

We may readily resolve any problem arising from the setting of the initial unit price for the gas. As we have seen, the restriction on contract-alteration by the Commission is not total; the Commission is authorized — indeed, is required — "to review" the parties' "rates and contracts . . . and, if they are determined to be unlawful, to remedy them,"[285] and to change them "in circumstances of unequivocal public necessity."[286] This is the power which the Commission exercises when it imposes upon a Section 7 certificate of public convenience and necessity a condition that a designated initial price be observed.

As the Supreme Court said in *CATCO*,

> The purpose of the Natural Gas Act was to underwrite just and reasonable rates to the consumers of

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[281] See text *supra* at notes 53-55, 80-83, 232-41.

[282] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 398-400, 404-07.

[283] See text *supra* at notes 84-87, 242-53.

[284] See Part IV (B), *supra*.

[285] See text *supra* at note 263.

[286] See text *supra* at note 278.

> natural gas[287] . . . . As the original § 7(c) provided, it was "the intention of Congress that natural gas shall be sold in interstate commerce for resale for ultimate public consumption for domestic, commercial, industrial, or any other use at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest[288] . . . The Act was so framed as to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges. The heart of the Act is found in those provisions requiring initially that any "proposed service, sale, operation, construction, extension, or acquisition . . . will be required by the present or future public convenience and necessity,"[289] . . . and that all rates and charges "made, demanded, or received" shall be "just and reasonable"[290] . . . . The Act prohibits such movements unless and until the Commission issues a certificate of public convenience and necessity therefor[291] . . . . Section 7(e) vests in the Commission control over the conditions under which gas may be initially dedicated to interstate use.[292]

Moreover, said the Court in *CATCO,* "[i]n view of [the statutory] framework in which the Commission is authorized and directed to act, the initial certificating of a proposal under § 7(e) of the Act as being required by the public

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[287] Citing *FPC* v. *Hope Natural Gas Co., supra* note 229.

[288] Citing 52 Stat. 725 (1938). In its footnote to text at this point, the Court observed:

> The 1942 amendments to § 7, 56 Stat. 83, were not intended to change this declaration of purpose. See Hearings, House Interstate and Foreign Commerce Committee, on H.R. 5249, 77th Cong., 1st Sess. 18-19; H.R. Rep. No. 1290, 77th Cong., 1st Sess.; S.Rep.No. 948, 77th Cong., 2d Sess.

Atlantic Ref. Co. v. *Public Serv. Comm'n, supra* note 10, 360 U.S. at 388 n.7.

[289] Citing Natural Gas Act § 7(e), as amended, 15 U.S.C. § 717f(e) (1970).

[290] Citing Natural Gas Act § 4, 15 U.S.C. § 717c (1970).

[291] Citing Natural Gas Act § 7(c), 15 U.S.C. § 717f(c) (1970).

[292] *Atlantic Ref. Co.* v. *Public Serv. Comm'n, supra* note 10, 360 U.S. at 388-89.

convenience and necessity becomes crucial."[293] This is partly "because the delay incident to determination in § 5 proceedings through which initial certificated rates are reviewable appears nigh interminable."[294] Undeniably, "the Act does not require a determination of just and reasonable rates in a § 7 proceeding as it does in one under either § 4 or § 5,"[295] nor is "a 'just and reasonable' rate hearing . . . a prerequisite to the issuance of producer certificates."[296] But "the inordinate delay presently existing in the processing of § 5 proceedings requires a most careful scrutiny and responsible reaction to initial price proposals of producers under § 7,"[297] and "[t]heir proposals must be supported by evidence showing their necessity to 'the present or future public convenience and necessity' before permanent certificates are issued."[298] And "[w]here the application on its face or on presentation of evidence signals the existence of a situation that probably would not be in the public interest, a permanent certificate should not be issued."[299]

The certificate-conditioning power of the Commission exercisable upon a Section 7 producer application is the vehicle by which the Commission is summoned and enabled to pro-

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[293] *Id.* at 389.

[294] *Id.* The Court pointed out that "long delay, without the protection of a refund, as is possible in a § 4 proceeding, would provide a windfall for the natural gas company with a consequent squall for the consumers," *id.* at 390, and that "the fact that the Commission was not given the power to suspend initial rates under § 7 makes it the more important, as the Commission itself says, that 'this crucial sale should not be permanently certificated unless the rate level has been shown to be in the public interest.' " *Id.,* citing *Continental Oil Co.* v. *FPC,* 17 F.P.C. 563, 575 (1957).

[295] *Atlantic Ref. Co.* v. *Public Serv. Comm'n, supra* note 10, 360 U.S. at 390.

[296] *Id.* at 390-91.

[297] *Id.* at 391.

[298] *Id.* See also text *supra* at notes 162-63.

[299] *Id.*

tect the public interest.[300] It is the "method by which the applicant and the Commission can arrive at a rate that is in keeping with the public convenience and necessity."[301] For "[t]he Congress in § 7(e), has authorized the Commission to condition certificates in such manner as the public convenience and necessity may require;"[302] and "[w]here the proposed price is not in keeping with the public interest . . . the Commission in the exercise of its discretion might attach such conditions as it believes necessary."[303]

From the regulatory scheme, thus analyzed, it is apparent that the establishment of an initial price in a Section 7 certificate proceeding does not ordinarily implicate the *Mobile-Sierra* rule. As in *CATCO* the Court explained:

> This is not an encroachment upon the initial rate-making privileges allowed natural gas companies under the Act, . . .[304] but merely the exercise of that duty imposed on the Commission to protect the public interest in determining whether the issuance of the certificate is required by the public convenience and necessity, which is the Act's standard in § 7 applications. In granting such conditional certificates, the Commission does not determine initial price nor does it overturn those agreed upon by the parties. Rather, it so conditions the certificate that the consuming public may be protected while the justness and reasonableness of the price fixed by the parties is being determined under other sections of the Act. Section 7 procedures in such situations thus act to hold the line awaiting adjudication of a just and reasonable rate. Thus the purpose of the Congress "to create a comprehensive and effective regulatory scheme"[305] . . . is given full recognition. And § 7 is given only that scope necessary for "a single statutory scheme under which all rates are established initially by the natural gas companies, by contract or otherwise, and all rates are subject to being modified by the Commission. . . ."[306] . . . . On the other hand, if unconditional certificates are issued where the rate is not clearly shown to be required by the public convenience and necessity, relief is limited to § 5 proceedings, and . . . full protection of the public interest is not afforded.[307]

[300] See text *supra* at notes 150-163.

[301] *Atlantic Ref. Co.* v. *Public Serv. Comm'n*, *supra* note 10, 360 U.S. at 391.

[302] *Id.*

[303] *Id.*

[304] Citing *United Gas Pipe Line Co.* v. *Mobile Gas Serv. Corp.*, *supra* note 256.

In Opinion No. 565, the Commission found that the lease-sale, even as amended by the reserve guaranty,[308] did not comport with the public convenience and necessity;[309] and that, in order that it might do so, it was essential that it be altered in certain respects.[310] In Opinion No. 565-A, the Commission adhered to that finding.[311] In Opinion No. 565, the Commission fixed an initial price,[312] and in Opinion No. 565-A, though it abrogated that price, it specified that the future area rate would become the initial price between Texas Eastern and the producers.[313] In Opinion No. 565, the Commission imposed a set of additional requirements

[305] Quoting *Panhandle Eastern Pipe Line Co.* v. *Public Serv. Comm'n*, 332 U.S. 507, 520 (1947).

[306] Quoting *United Gas Pipe Line Co.* v. *Mobile Gas Serv. Corp.*, *supra* note 256, 350 U.S. at 341.

[307] *Atlantic Ref. Co.* v. *Public Serv. Comm'n*, *supra* note 10, 360 U.S. at 391-92.

[308] See note 40, *supra*.

[309] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 382-90. See also Part III(C), *supra*.

[310] *Id.*

[311] *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1081, 1083-85. See also text *supra* at note 213.

[312] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 383-87.

[313] *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1085-87.

to adjust the lease-sale arrangement to the pricing prescribed.[314] While in Opinion No. 565-A, the Commission suspended some of those requirements, it was not because they lacked an intimate connection with the initial price which Opinion No. 565 had set.[315] To the extent that these specifications changed the parties' lease-sale contract, they were manifestly designed to serve the public convenience and necessity[316] — a necessity born of the great difficulty, if not the impossibility, of otherwise ascertaining and effectuating an initial price for the gas, and consequently of protecting consumers against excessiveness.[317] In these modifications, we perceive no impingement upon the *Mobile-Sierra* doctrine.

— *The Total Price*

As we have stated, Texas Eastern argues strenuously that the Commission's decision to eliminate the $134 million lease-sale contract price as the ceiling of its monetary liability to the producers for their Rayne Field gas stands on entirely different ground. We find, upon careful examination of this particular change, that Texas Eastern's position is well taken. We accordingly hold that the Commission's action in that regard cannot be supported as an appropriate exercise of its contract-revision authority under the narrow exception to the *Mobile-Sierra* rule.

Before elucidating the reasons persuading us to that conclusion, we pause to address two preliminary considerations. The producers and the Commission point to the

[314] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 390-400.
[315] *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1085-89.
[316] See text *supra* at notes 285-307.
[317] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 389; *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1083.

uncertainties as to the volume of gas in the field, the quantity and value of liquids that may be extracted, the amount of future state taxes and the size of salvage recoveries; and on that basis they argue that the displacement of the contract price by a unit price payable throughout the life of the field does not absolutely forebode an increase of the cost of the gas to Texas Eastern. In the view of three members of the Commission — a majority in Opinion No. 565-A, in which the displacement was directed — such an increase would indeed follow. Commissioner O'Connor estimated that the producers would gain "an additional $52,141,000."[318] Commissioners Carver and Brooke put the gain in current dollars at between $17,637,000 and $25,912,000.[319] All three commissioners recognized that these figures would go higher if the area rate for Southern Louisiana producers were raised prospectively above 18.5 cents per Mcf.[320] Neither of the two remaining Commission members indicated in Opinion No. 565-A any belief that the linking of Texas Eastern's payments to the full period of productive activity was not an extracontractual financial boon to the producers.[321] Moreover, the Section 7 certification proceeding does not tolerate the kind of cost figuring which a more solid determination on the matter of increase, if possible at all, would unavoidably necessitate.[322] In these circumstances,

[318] *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1096.
[319] *Id.* at 1103.
[320] *Id.* at 1096 n.11, 1103.
[321] See *id.* at 1085-86.
[322] Compare *United Gas Improvement Co.* v. *Callery Properties*, *supra* note 151, 382 U.S. at 226-28. There the Court reversed a holding that the Commission could not utilize the in-line price as the initial price in a Section 7 certification proceeding without canvassing evidence as to what a just and reasonable price would be. "To consider in this § 7 proceeding the mass of evidence relevant to the fixing of just and reasonable rates under § 5 might in practical effect render nugatory any effort to fix initial prices." Id. at 227-28. See also text *supra* at notes 155-63.

we feel bound to accept the premise that the contract price was substantially raised.

Beyond that, the fundamental teaching of *Mobile* and *Sierra* is that the parties' agreement, and not the Commission's bent, sets the price of gas for purposes of administrative regulation unless overriding considerations of public convenience and necessity unmistakably appear.[323] We deem this the governing rule not only where, in consequence of the Commission's action, a raising of the contract price of gas is evident but also where it is reasonably likely. For it is the prerogative of each contracting party to seek protection in a firm price, and to insist upon it if it becomes a term of the contract. Texas Eastern and the producers stipulated such a price in their lease-sale contract, and Texas Eastern is free to demand the financial security which it provides. Like any other estimate, the views that elimination of the contract price inexorably increased Texas Eastern's gas costs cannot rise to the level of complete certainty. But it cannot be gainsaid that, at the very least, eradication of the contract price poses the serious threat that Texas Eastern may have to pay the producers much more. That, we think, is enough to give substance to Texas Eastern's complaint, and to bring the *Mobile-Sierra* restriction into play.

There is another preliminary matter which the producers' position presents. They contend also that because the applications to the Commission invoked its Section 7 power to confer certification, and not its Section 5 authority to review rates for their reasonableness, the *Mobile-Sierra* doctrine does not apply. Like the Third Circuit, however, we deem this "an immaterial difference."[324] *Mobile* and *Sierra*

[323] See Part IV (B), *supra*.

[324] *Natural Gas Pipeline Co.* v. *FPC*, 253 F.2d 3, 7 (3d Cir.), *cert. denied*, 357 U.S. 927 (1958).

together ordain that a party to a gas contract may not unilaterally increase the contract price,[325] and they also specify the only condition under which the Commission can elevate that price.[326] We cannot read either of those decisions as a holding that, absent an exigent public interest, the Commission can exercise a prerogative which the parties contractually denied to themselves. Nor do we find in Section 7 a grant to the Commission of greater power over contract prices than it possesses under Sections 4 and 5. On the contrary, it is our clear understanding from the Supreme Court's *CATCO* decision,[327] which we have already extensively analyzed,[328] that the *Mobile-Sierra* rule applies full force to Section 7 proceedings.[329] We conclude that the Commission was as much bound to preserve the integrity of the contract price in this case as in any other.

This brings us to a consideration of the propriety of the Commission's holding in Opinion No. 565-A that instead of discharging the fixed purchase-price obligation defined in the lease-sale contract, Texas Eastern must continue its gas-purchase payments to the producers until the transferred reserves are exhausted. The majority vote[330] to make that change was predicated upon a single ground: that "it appears that while the Producers, under the arrangement we prescribed [in Opinion No. 565], will be getting the contract price it will not be of the same value because they

[325] See Part IV (B), *supra*.

[326] See Part IV (B), *supra*.

[327] *Atlantic Ref. Co.* v. *Public Serv. Comm'n, supra* note 10.

[328] See notes 161-63, 304-07, *supra*.

[329] *Atlantic Ref. Co.* v. *Public Serv. Comm'n, supra* note 10, 360 U.S. at 391-92, quoted in text *supra* at notes 304-07.

[330] We remind that Opinion No. 565-A gained a majority only because Commissioners Carver and Brooke joined Chairman Nassikas and Commissioner Bagge to make possible a disposition more palatable to them than the disposition proposed in Opinion No. 565. See text *supra* at notes 76-90, 111-13.

will receive it over a much longer period, and they will not receive the benefit of all the gas and liquids produced by the Field as they would under a conventional contract."[331] For that reason alone, it was concluded "that it is only equitable that they be paid for the gas and receive credit for the liquids produced until the Field is exhausted."[332]

We think it clear that the Commission's direction to that end does not survive the *Mobile-Sierra* test. That test, as we have seen, is not whether a contractual provision seems to be equitable to the contracting parties but whether it is detrimental to the public interest.[333] It bears repeating that "[t]he regulatory system created by the Act is premised on contractual agreements voluntarily devised,"[334] and that "it contemplates abrogation of these agreements only in circumstances of unequivocal public necessity."[335] Unlike the conventionalizing provisions of Opinion No. 565 responsive to the dire public need to establish an initial unit price for the gas,[336] the Commission's alteration of the stipulated aggregate price has not been shown to serve any facet of the public interest at all.

The Commission did not find that the $134 million contract price was "so low as to adversely affect the public interest."[337] It did not find "financial or other difficulties that required the Commission to relieve the producers . . . from the burdens of their contractual obligations."[338] Nor

[331] *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1085.

[332] *Id.*

[333] See Part IV (B), *supra*.

[334] *Permian Basin Area Rate Cases (Continental Oil Co.* v. *FPC)*, *supra* note 69, 390 U.S. at 822.

[335] *Id.*

[336] See text *supra* at notes 285-317.

[337] *FPC* v. *Sierra Pac. Power Co.*, *supra* note 269, 350 U.S. at 355.

[338] *Permian Basin Area Rate Cases (Continental Oil Co.* v. *FPC)*, *supra* note 69, 390 U.S. at 822.

did it find that the apparent enlargement of Texas Eastern's ultimate financial liability was essential to conventionalization of the lease-sale arrangment.[339] It simply felt it "only equitable" to lift the $134 million ceiling on the total consideration the producers were to receive in order to adjust the difference in time value of the money and to assure remuneration for all gas and liquids yielded. It may be that, as things turned out, the producers would have been better off had the parties not substituted the lease-sale for the original gas-sale transaction, but "the Commission may not, absent evidence of injury to the public interest, relieve a" contracting party "of 'its improvident bargain.'"[340] It follows that the Commission's attempt to extend Texas Eastern's payments over the life of Rayne Field must be set aside.

That is not to say, however, that its counterpart in Opinion No. 565 is invulnerable. Except as the exigencies of the public interest demanded, the Commission was no more at liberty to alter the lease-sale contract to the prejudice of the producers than to do so in their favor. Opinion No. 565, by limiting Texas Eastern's financial liability to the contract price and simultaneously spreading its discharge over a longer period of time, would cause the

[339] Counsel for the Commission argue that the scrapping of the $134 million contract price was a necessary step in conventionalization of the lease-sale so as to make it regulable. The Commission, however, did not rely on that ground, see Part III (C), *supra*, and rationalizations by counsel which were not reasons for the agency decision are unacceptable on judicial review. *Burlington Truck Lines* v. *United States*, 371 U.S. 156, 168-69 (1962); *Texas Gas Transmission Corp.* v. *Shell Oil Co.*, 363 U.S. 263, 270 (1960); *SEC* v. *Chenery Corp.*, 332 U.S. 194, 196 (1947). Furthermore, the transaction could readily have been conventionalized without elevation of the contract price. See text *supra* at notes 242-45, 246-49.

[340] *Permian Basin Area Rate Cases* (*Continental Oil Co.* v. *FPC*), *supra* note 69, 390 U.S. at 821, quoting *FPC* v. *Sierra Pac. Power Co.*, *supra* note 269, 350 U.S. at 355.

producers to receive less than the *quid pro quo* for which they contracted. That is because the value to the producers of the money to be paid over the longer time span would be less than its value by the payment schedule embodied in the lease-sale arrangement.[341] The Commission, in conventionalizing the lease-sale in the public interest[342] was virtually compelled to change that schedule, and we have sustained its action in doing so;[343] but in the process the producers were deprived of a part of their bargain.

Every member of the Commission has come to recognize the producers' plight demands rectification,[344] but we see no need for a remand to the Commission for its accomplishment. A majority of the Commission has held on five occasions that the public convenience and necessity would not be served by certificaton of the lease-sale as a lease-sale,[345] and on two occasions that conventionalization was necessary in the public interest,[346] with a linking of Texas Eastern's

[341] See. *e.g.*, the discussion in *Texas Eastern Transmission Corp.*, *supra* note 100, 44 F.P.C. at 1471-73 (separate opinion of Commissioner O'Connor) (order denying rehearing).

[342] See Part III (C), *supra*.

[343] See text *supra* at notes 308-17.

[344] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 436 (Commissioners Carver and Brooke); *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1085 (Chairman Nassikas and Commissioner Bagge); *id.* at 1098 (Commissioners Carver and Brooke); *Texas Eastern Transmission Corp.*, *supra* note 100, 44 F.P.C. at 1472 (Commissioner O'Connor) (order denying rehearing); *Id* at 1473 (Commissioners Carver and Brooke).

[345] *Texas Eastern Transmission Corp.* (Opinion No. 378), *supra* note 31, 29 F.P.C. at 256-57; *Texas Eastern Transmission Corp.* (Opinion No. 378-A), *supra* note 35, 30 F.P.C. at 156; *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 382-83, 387-90; *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1083-85; *Texas Eastern Transmission Corp.*, *supra* note 100, 44 F.P.C. at 1471 (order denying rehearing).

[346] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 389-90; *Texas Eastern Transmission Corp.*, (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1083-85.

gas-purchase payments to gas-deliveries.[347] With these holdings, which the Commission deems unavoidable and which we have no basis for disturbing, the only alternative legally available to the Commission is an increase in Texas Eastern's payments beyond the aggregate $134 million contract price by an amount equal to the time value of the money to be paid on the Commission-rearranged payment schedule.[348] That would confer on the producers the full equivalent of their contract price, and would impose on Texas Eastern no more than the equivalent of its contract cost; and the economic positions of both parties would then be harmonized with *Mobile-Sierra* requirements.[349] Our judgment on this review will, in lieu of a remand for the purposes, incorporate such a modification in the Commission's disposition.

[347] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 390-91; *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1085-86.

[348] Texas Eastern seems also to recognize the need for this adjustment. In its reply brief (p. 11), it agreed that the elimination in Opinion No. 565-A of the $134 million price ceiling was unnecessary since, as an alternative its payments to producers could be adjusted upward to take account of the time value of the money paid on the plan of conventionalization set forth in Opinion No. 565, and the producers would thereby realize the same consideration as they would have under the lease-sale contract.

[349] We disagree with the Commission's conclusion in Opinion No. 565-A that the $134 million price ceiling could be dissolved in order to require Texas Eastern to pay for all of the gas and liquids produced over the life of the field. See text *supra* at notes 250-51. By the parties' contract, payment of the $134 million purchase price entitled Texas Eastern to all of the gas in place in the producers' Rayne Field holdings and to all liquids extracted from the gas. In no way did Opinion No. 565 undertake to change this feature of the contract, see text *supra* at note 245, nor was the Commission free to do so in Opinion No. 565-A. The Commission has pointed to no "circumstances of unequivocal public necessity," see text *supra* at note 335, which would warrant that treatment consistently with the *Mobile-Sierra* rule.

V. Producer Rates and Refunds

Having decided to conventionalize the lease-sale transaction,[350] with a view to establishment of an initial unit price for the producers' gas as the major product of conventionalization,[351] the Commission then embarked upon achievement of that goal. The task which the Commission undertook may be defined quite simply. An initial price for the gas, geared to actual deliveries, would fix a ceiling on the payments which Texas Eastern would thereafter make to the producers. It might also serve as the point of reference for financial adjustments between the parties, which past remittances on the schedule of the lease-sale purchase-price payments would almost certainly make inevitable. In addressing these matters the Commission was, however, to travel a long and tortuous path to an inconclusive end.

In Opinion No. 565, a majority of the Commission held that the certificates issued to Texas Eastern and the producers should be conditioned upon an initial price of 20 cents per Mcf for gas delivered to October 1, 1968, and at the price of 18.5 cents on deliveries thereafter.[352] The 20-cent price was the in-line price, as determined by the Commission.[353] The 18.5-cent price was the just and reasonable area rate which the Commission had recently set in the *Southern Louisiana Area Rate Proceeding*.[354] The changeover date was the date on which the area rate took effect.[355] The order

[350] See Part III (C), *supra*.

[351] See Part IV(A), (C), (2), *supra*.

[352] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 383-93.

[353] *Id.* at 384. See also *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1086-87.

[354] (Opinion No. 546), *supra* note 53.

[355] See *Southern Louisiana Area Rate Proceeding* (Opinion No. 546-A), 41 F.P.C. 301, 309, 341 (1969).

accompanying Opinion No. 565 directed Texas Eastern to make payments to the producers, and the producers to make refunds to Texas Eastern, in accordance with that formula.[356] Chairman White was of the view that the price should have been fixed at the 18.5-cent just and reasonable rate from the time the flow of the gas commenced in 1959.[357]

In Opinion No. 565-A, however, this disposition was changed radically. A majority of the Commission rallied to the position expressed earlier by Chairman White,[358] who no longer was a member of the Commission, but concluded that no just and reasonable area rate had been finally determined.[359] On that ground, the majority held that Texas Eastern should pay the producers the 20-cent in-line rate on future gas deliveries until a firm area rate was forthcoming.[360] On the same ground and others, the majority also held that producer refunds should be deferred until then.[361] The Commission subsequently denied a rehearing of that decision.[362]

We find the resolutions of the Commission majorities in Opinions Nos. 565 and 565-A legally unacceptable. We hold that, as a matter of law, the Commission was compelled to utilize the previously ascertained 18.5-cent just and reasonable area rate both as the unit price for the gas deliveries

[356] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 403-05.

[357] *Id.* at 417-22.

[358] *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1085-86.

[359] *Id.* at 1086.

[360] *Id.* at 1087.

[361] *Id.* at 1087-88.

[362] *Texas Eastern Transmission Corp.*, *supra* note 100, 44 F.P.C. at 1471 (order denying rehearing).

to be made and as the basis for refunds by the producers on account of deliveries already made. We further hold that the Commission was legally obliged to order the producers to make those refunds to Texas Eastern immediately.

A. *The General Standard For Producer Rates*

"The purpose of the Natural Gas Act," the Supreme Court instructs, "was to underwrite just and reasonable rates to the consumers of natural gas."[363] Its "primary aim . . . was to protect consumers against exploitation at the hands of natural gas companies."[364] Section 4(a) of the Act specifies that "[a]ll rates and charges . . . by any natural-gas company"[365] on the "sale of natural gas" regulable by the Commission "shall be just and reasonable";[366] and by that section, "any such rate or charge that is not just and reasonable is declared to be unlawful."[367] Nowhere does the Act in terms condone any rate or charge other than the one that would be just and reasonable. Nowhere does the Act suggest that a rate or charge above that which would be just and reasonable is not unlawfully excessive. Nor can it be gainsaid that "[t]he Act was so framed as to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges."[368]

[363] *Atlantic Ref. Co.* v. *Public Service Comm'n, supra* note 10, 360 U.S. at 388.

[364] *FPC* v. *Hope Natural Gas Co., supra* note 229, 320 U.S. at 610.

[365] The producers are "natural gas compan[ies]" within the meaning of the Act. Natural Gas Act § 2(6), 15 U.S.C. § 717a(6) (1970); *Phillips Petroleum Co.* v. *Wisconsin, supra* note 6, 347 U.S. at 676-77.

[366] "All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable and any such rate or charge that is not just and reasonable is declared to be unlawful." Natural Gas Act § 4(a), 15 U.S.C. § 717c(a) (1970).

[367] See note 366, *supra.*

The Commission's responsibility to hearken to these policies attaches at the very moment it is requested to certificate activities within its regulatory domain. Section 7(e) imposes upon it the duty to determine whether a "proposed service, sale, operation, construction, extension, or acquisition . . . will be required by the present or future public convenience and necessity."[369] By the same token, that section "vests in the Commission control over the conditions under which gas may be initially dedicated to interstate use."[370] That authority extends indubitably to a determination as to whether the charges which a producer proposes to make for his gas are in the public interest.[371] Indeed, Section 7(c) of the Act itself originally articulated "the intention of Congress that natural gas shall be sold in interstate commerce for resale for ultimate public consumption . . . at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest."[372] That objective, though no longer expressly stated, stands as a major congressional concern today.[373]

To be sure, "the Act does not require a determination of just and reasonable rates *in* a § 7 proceeding as it does in one under either § 4 or § 5," [374] nor is "a 'just and rea-

[367] See note 366, *supra.*

[368] *Atlantic Ref. Co.* v. *Public Serv. Comm'n, supra* note 10, 360 U.S. at 388.

[369] Natural Gas Act § 7(e), 15 U.S.C. § 717(e) (1970). See also *Atlantic Ref. Co.* v. *Public Serv. Comm'n, supra* note 10, 360 U.S. at 388.

[370] *Atlantic Ref. Co.* v. *Public Serv. Comm'n, supra* note 10, 360 U.S. at 389.

[371] See text *supra* at notes 263, 278, and Part IV(C) (1), *supra.*

[372] 52 Stat. 825 (1938).

[373] *Atlantic Ref. Co.* v. *Public Serv. Comm'n, supra* note 10, 360 U.S. at 388.

sonable' rate hearing . . . a prerequisite to the issuance of producer certificates."[375] The setting of the producer's initial price at the just and reasonable rate, were that course feasible, would, of course, contribute handsomely to the consumer-protection goal of the Act. But as we have seen, the exigencies of prompt initial certification of gas sales and pipeline extensions preclude, within the certification proceedings themselves, fullfledged investigations worthy of a "just and reasonable" appellation.[376] That is not to say that the Commission need not bend its best efforts to achieve an equitable price arrangement when it awards certification under Section 7. On the contrary, the very delay incidental to just-and-reasonable-rate investigations "requires a most careful scrutiny and responsible reaction to initial price proposals of producers under § 7."[377] "[P]rice [is] a consideration of price importance"[378] in the certification process, and "if unconditional certificates are issued where the rate is not clearly shown to be required by the public convenience and necessity, . . . full protection of the public interest is not afforded."[379]

B. *The Treatment Of Producer Rates*

In Opinion No. 565, a majority of the Commission decided that the price to be paid to the producers for gas deliveries to Texas Eastern after the effective date of the Commission's decision in *Southern Louisiana Area Rate*

[374] *Id.* at 390 (emphasis supplied). See Natural Gas Act §§ 4, 5, 15 U.S.C. §§ 717c, 717d (1970).

[375] *Atlantic Ref. Co.* v. *Public Serv. Comm'n*, *supra* note 10, 360 U.S. at 390-91.

[376] See Part III (A) *supra*.

[377] *Atlantic Ref. Co.* v. *Public Serv. Comm'n*, *supra* note 10, 360 U.S. at 391. See also *FPC* v. *Sunray DX Oil Co.*, *supra* note 151, 391 U.S. at 17-18.

[378] *Atlantic Ref. Co.* v. *Public Serv. Comm'n*, *supra* note 10, 360 U.S. at 391.

[379] *Id.* at 392.

Proceeding[380] should be set at the just and reasonable rate of 18.5 cents ascertained therein.[381] Said the Commission:

> Here we are issuing a certificate under Section 7 of the Natural Gas Act. Section 7(c) provides that we have power to attach to the certificate "such reasonable terms and conditions as the public convenience and necessity may require."[382] We think it reasonable . . . to require that the Producers reduce their rates prospectively to an effective 18.5 cents per Mcf in accordance with [the area rate determination].[383]

In Opinion No. 565-A, the Commission majority held similarly that the just and reasonable rate should govern the initial price for prospective gas deliveries.[384] The Commission concluded, however, that the area rate for Southern Louisiana producers had not been finally resolved.[385] So, with respect to the future pricing of the gas, the Commission said:

> Since we have stayed this rate as a result of the court's review of our area decision[386] and the appropriate rate is still subject to further proceedings, we shall require that the producer rate schedule filing be on the basis of 20 cents per Mcf, the in-line price in Southern Louisiana as found in our original opinion. When the Southern Louisiana rate is finally determined, we shall require that this basic producer rate be modified accordingly.[387]

[380] (Opinion No. 546), *supra* note 53. See text *supra* at notes 69-75.

[381] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 383-93.

[382] 15 U.S.C. § 717f(c) (1970).

[383] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 385.

[384] *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1085-86.

[385] *Id.*

[386] *Southern Louisiana Area Rate Proceeding* (Opinion No. 546), *supra* note 53. See text *supra* at notes 69-75.

[387] *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1086 (Footnote omitted).

The challenge we are now summoned to resolve is to the Commission's substitution by Opinion 565-A of the in-line rate for the just and reasonable rate employed in Opinion No. 565 as the measure of the initial price to be paid by Texas Eastern to the producers for future deliveries of natural gas.

-- (1) *The Choice Of The In-Line Price*

The unfeasibility of establishing a just and reasonable rate within the framework of a Section 7 certification proceeding[388] ofttimes forces resort to some other means of fixing an initial price for newly certificated gas in the public interest. So it is that the in-line price frequently becomes the criterion — simply because it is the only point of reference extant.[389] Where that is so, it is settled that the in-line price may legitimately be utilized as the initial price imposed as a condition qualifying the certificate issued.[390] The in-line price thus functions as the ceiling on the price at which the gas may be sold pending ascertainment of the just and reasonable rate.[391]

It is evident, however, that use of the in-line price as the yardstick for the initial-price determination on certification cannot be justified in situations where a just and reasonable area rate for gas of the vintage in question has already been established. The goal of gas-pricing

[388] See Part III (A), *supra*.

[389] See *FPC* v. *Sunray DX Oil Co. supra* note 151, 391 U.S. at 18-20; *United Gas Improvement Co.* v. *Callery Properties, supra* note 151, 382 U.S. at 226-28.

[390] *FPC* v. *Sunray DX Oil Co., supra* note 151, 391 U.S. at 18-20; *United Gas Improvement Co.* v. *Callery Properties, supra* note 151, 382 U.S. at 226-28.

[391] *FPC* v. *Sunray DX Oil Co., supra* note 151, 391 U.S. at 21-22, 25-26; *United Gas Improvement Co.* v. *Callery Properties, supra* note 151, 382 U.S. at 226-28.

to which the Act emphatically speaks is the just and reasonable rate,[392] for which the in-line price is not a reliable substitute. As the Supreme Court has pointed out, where the Commission has decided "to rely solely upon contemporaneous contract prices in setting initial rates, there can be no assurance that an initial price arrived at by the Commission will bear any particular relationship to the just and reasonable rate."[393] Rather, as we have explained, adoption of the in-line price as the initial price is merely an interim measure designed to hold the line until the just and reasonable rate for the gas can be ascertained.[394] If that rate, by reason of a past determination, is already available, its use as the initial price for future gas sales follows logically and, we think, legally as a normal concomitant of certification.

Just and reasonable rates for jurisdictional gas, we repeat, are the end and aim of price regulation under the Act.[395] They are the ultimate in the pricing of the natural gas over which the Commission exerts its authority. That the Section 7 proceeding is directed primarily at certifica-

[392] See Part V(A), *supra*.

[393] *FPC* v. *Sunray DX Oil Co., supra* note 151, 391 U.S. at 25. The Court added:

> Any such assurance would necessarily be based on a belief that the current contract prices in an area approximate closely the "true" market price — the just and reasonable rate. Although there is doubtless some relationship, and some economists have argued that it is intimate, such a belief would contradict the basic assumption that has caused natural gas production to be subjected to regulation and which must have underlain this Court's *CATCO* decision — namely, that the purchasing pipeline, whose cost of purchase is a current operating expense which the pipeline is entitled to pass on to its customers as part of its rates, lacks sufficient incentive to bargain prices down.

391 U.S. at 25-26 (Footnotes omitted).

[394] See text *supra* at notes 388-91.

[395] See Part V(A), *supra*.

tion rather than ratemaking does not diminish the Commission's duty to fix initial prices which are calculated to best serve the public weal. The congressional intent underlying Section 7 is that jurisdictional gas shall, from the very beginning, "be sold . . . at the *lowest possible reasonable rate* consistent with the maintenance of adequate service in the public interest."[396] Ordinarily that policy is frustrated by selection of an in-line price over a just and reasonable price that is for the asking.

As we see it, only the presence of an overriding consideration promoting an identifiable legislative purpose can justify administrative displacement of the just and reasonable rate through approval of another rate for gas to which the Act applies. The need for prompt setting of an initial price in a Section 7 certification proceeding becomes such a consideration where there is no just and reasonable rate as yet.[397] But where, on the other hand, the just and reasonable rate has been established when the Commission comes to fix an initial price for gas, there is simply no need to resort to any other rate.

Two courts, for the purpose of computing producer refund liabilities in Section 7 proceedings, have passed over the in-line price for natural gas in favor of the just and reasonable area rate which had become available.[398] It is even plainer to us that, absent unusual circumstances, that course must be pursued when the Commission is called upon to set initial prices prospectively. In our view, the Commission is legally compelled to peg a producer's initial price

[396] See text *supra* at note 372 (emphasis supplied).

[397] See *FPC* v. *Sunray DX Oil Co. supra* note 151, 391 U.S. at 25-26.

[398] *Hunt Oil Co.* v. *FPC*, 424 F.2d 982, 986 (5th Cir. 1970); *Phillips Petroleum Co.* v. *FPC, supra* note 221, 405 F.2d at 9. See also Part V(C), *infra*.

at a previously ascertained just and reasonable rate unless some consideration effectuating a countervailing congressional policy is shown on balance to outweigh the congressional interest in "just and reasonable rates to the consumers of the natural gas."[399]

— (2) *The Status of the Southern Louisiana Area Rate Proceeding*

On September 25, 1968, the Commission capped a seven-year-old rate investigation with its Opinion No. 546 in Docket No. AR61-2 — the *Southern Louisiana Area Rate Proceeding*.[400] By that decision, the Commission fixed just and reasonable price ceilings, including a minimum of 18.5 cents for natural gas of the Rayne Field vintage, for the Southern Louisiana production area.[401] The orders effectuating Opinion No. 546 soon came under review in the Fifth Circuit.[402] Producers and pipelines challenged the rates as too low, while consumer interests argued that they were too high. On March 10, 1970, the court sustained the orders "in full".[403]

In the meantime, the Commission, on March 20, 1969, had issued its Opinion No. 546-A in response to applications for rehearing of Opinion No. 546.[404] In Opinion No. 546-A, the Commission modified Opinion No. 546 in some

[399] See text *supra* at note 363.

[400] (Opinion No. 546), *supra* note 53. The proceeding had been instituted by an order issued May 10, 1961. *Southern Louisiana Area Rate Proceeding*, 25 F.P.C. 942 (1961) (order instituting proceeding).

[401] *Southern Louisiana Area Rate Proceeding* (Opinion No. 546), *supra* note 53, 40 F.P.C. at 544, 636, 648.

[402] *Southern Louisiana Area Rate Cases*, (*Austral Oil Co.* v. *FPC*), *supra* note 53.

[403] 428 F.2d at 444.

[404] *Southern Louisiana Area Rate Proceeding* (Opinion No. 546-A), *supra* note 355.

respects, but refused to reopen the investigation or to readjust the price levels set.[405] The Commission felt, however, that the importance of an additional supply of gas from the offshore areas of Southern Louisiana warranted the commencement of another proceeding looking forward to possible revision of the area price for such gas.[406] The Commission rejected suggestions that the new proceeding — Docket No. AR69-1 — should embrace a further inquiry into the adequacy of the rates promulgated in Opinion No. 546 for gas produced onshore in the Southern Louisiana area.[407] Within nine months, however, the Commission changed its mind as to the scope of the new investigation. On December 15, 1969, the Commission issued an order enlarging the proceeding to include the entire geographical area of Southern Louisiana, onshore as well as offshore, and to provide for a review of the just and reasonable rates for all vintages of gas therefrom.[408]

The order expanding the investigation in Docket No. AR69-1 came shortly prior to oral argument in the Fifth Circuit on its review of Opinion No. 546, the original Southern Louisiana area rate proceeding, occasioning a pause to consider the impact of that investigation on the pending review.[409] The court agreed with the parties that it had no effect,[410] pointing out that

> The maximum rates that the Commission has set . . . are to remain in effect throughout the new proceeding, which may last for years. Moreover, it was never contemplated that there should be a single area proceeding setting rates once and for all; rather the Commission has always made it clear that it intended to review the rates it had set whenever the circumstances made it advisable to do so.[411]

[405] *Id.* at 308-42.

[406] *Id.* at 306-07. The new investigation, Docket No. AR69-1, was launched immediately. *Southern Louisiana Area Rate Proceeding*, 41 F.P.C. 378 (1969) (order instituting proceeding).

[407] *Id.* at 307-08.

[408] *Southern Louisiana Area Rate Proceeding*, 42 F.P.C. 1110, 1111, 1113 (1969) (order enlarging proceeding).

[409] *Southern Louisiana Area Rate Cases* (*Austral Oil Co. v. FPC*), *supra* note 53, 428 F.2d at 421.

[410] *Id.*

And in upholding the orders under review, the Court stated:

> The mandate of this Court should not, however, be interpreted to interfere with Commission action that would change the rates we have approved here. We specifically and emphatically reject the contention . . . that the Commission has no power to set aside rates once determined by it to be just and reasonable when it has reason to believe its determination may have been erroneous.[412] In fact, the existence of the new proceedings, which as we understand will take into account many of the issues whose absence has concerned us here, has been one of the factors we have considered in deciding to affirm the Commission's decisions.[413]

Such was the history of the Southern Louisiana area rate inquiry at the time the Commission handed down

[411] *Id.* at 421 n.27. In the *Southern Louisiana Area Rate Proceeding* (Opinion No. 546), *supra* note 53, 40 F.P.C. at 644, the Commission had stated that area rates "will be modified if a showing is made that unit costs — reflecting amounts spent and reserves found — have increased to such an extent that an increase in area rates is required."

[412] In a footnote at this point, the court noted that "Section 16 of the Natural Gas Act, 15 U.S.C. § 717o (1963), gives the Commission power to 'perform any and all acts, and to prescribe, issue, make, amend, *and rescind* such orders as it may find necessary or appropriate to carry out the provisions of this chapter' (emphasis added)." *Southern Louisiana Area Rate Cases* (*Austral Oil Co. v. FPC*), *supra* note 53, 428 F.2d at 445 n.124.

[413] *Id.* at 444-45. Subsequently, in an unpublished order entered on rehearing, the court further explained:

Opinion No. 565-A. We cannot agree with the Commission that the events we have recited rendered Opinion No. 546 so tentative in character as to support the Commission's refusal in Opinion No. 565-A to employ the 18.5-cent just and reasonable rate as the initial price to be paid to the producers for gas delivered after the effective date of that rate. By Opinion No. 546 and its related orders, which came long prior to Opinion No. 565-A, the Commission had fixed the just and reasonable rate for Southern Louisiana gas of the Rayne Field vintage at 18.5 cents per Mcf. On review of that rate and others promulgated in Docket No. AR61-2, the Fifth Circuit had affirmed the Commission's orders.[414] In the process of doing so, the court had ruled that the reviewability of the orders accompanying Opinion No. 546 were unaffected by the pendency of Docket No. AR69-1—the new Southern Louisiana area rate investigation.[415] We

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> At the same time, we emphasize that our judgment is an affirmance and not a remand. The appropriate place for originally considering what parts of the orders must be reopened in light of new evidence is before the Commission. It may be that the Commission will decide that the refunds it has ordered are just and reasonable or at least that their significance to the public interest is outweighed by the confusion and delay that would result from their reopening. In this event, the Commission will allow its refund orders to stand as they are. Or it may be that the refunds are too burdensome in light of new evidence to be in the public interest. In that case, it is our judgment that the Commission shall have the power and the duty to remedy the situation by changing its orders.

Southern Louisiana Area Rate Cases (*Austral Oil Co.* v. *FPC*), No. 27492 (5th Cir. June 16, 1970) (unreported).

[414] And the Supreme Court subsequently denied all applications for review of Opinion No. 546 on certiorari. 400 U.S. 950 (1970).

[415] See text *supra* at notes 409-15.

The act does not expressly confine judicial review in natural gas cases to final orders. Rather, it provides that "[a]ny party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such orders. . . ." Natural Gas Act § 19(b), U.S.C. §717r(b) (1970). Construed in context, however, that provision requires a substantial degree of finality in an order of which review is sought. Its exact counterpart in the Federal Power Act "relates to orders of a definitive character dealing with the merits of a proceeding before the Commission and resulting from a hearing upon evidence and supported by findings appropriate to the case." *FPC* v. *Metropolitan Edison Co.*, 304 U.S. 375, 384 (1938). We have given the review provision in the Natural Gas Act the very same constructions. *Texas Gas Corp.* v. *FPC*, 102 U.S.App.D.C. 59, 61-62, 250 F.2d 27, 29-30 (1957); *United Gas Pipe Line Co.* v. *FPC*, 86 U.S.App.D.C. 314, 316-17, 181 F.2d 796, 798-99, *cert. denied*, 340 U.S. 827 (1950); see also *City of Chicago* v. *FPC*, 147 U.S. App.D.C. 312, 321-33, 458 F.2d 731, 740-41 (1971), *cert denied*, 405 U.S. 1074 (1972). Other courts have done so as well. *Algonquin Gas Transmission Co.* v. *FPC*, 201 F.2d 334, 337-38 (1st Cir. 1953); *United Gas Pipe Line Co.* v. *FPC*, 206 F.2d 842, 844-45 (3d Cir. 1953); *Amerada Petroleum Corp.* v. *FPC*, 285 F.2d 737, 739 (10th Cir. 1960).

In the *Southern Louisiana Area Rate Cases*, the Fifth Circuit, with the concurrence of all parties, concluded that the area rates fixed by Opinion No. 546 and its related orders were reviewable notwithstanding that the rate investigation in Docket No. AR69-1 "will probably result in substantial modifications on the rates set in this case," 428 F.2d at 421, that it "may affect rates for all vintages," *id.*, and that "the data the Commission has called for reflects the possibility of a radical change in approach," *id.* We accept that conclusion as a holding that, despite the susceptibility of the area rates to change, they retained a good deal of finality, for such an "order to be reviewable must be administrative action of a substantial character approaching some degree of finality." *Algonquin Gas Transmission Co.* v. *FPC*, *supra*, 201 F.2d at 337.

think that the 18.5-cent rate established by those orders was no less definitive and definite in its role as the legally appropriate criterion for the initial price which Rayne Field producers would be permitted to charge.

It is true that the Fifth Circuit, in affirming Opinion No. 546, spoke to the Commission's authority to reopen the orders accompanying it. We read that reference as no more than a recognition of the Commission's prerogative — and duty — to revise rates when they are found to be inconsistent with the public interest. Section 16 of the Act expressly empowers the Commission to "amend[] and rescind . . . orders . . . as it may find necessary or

appropriate to carry out the provisions of this [Act]".[416] That power undoubtedly extends to alteration of an existing rate upon a determination that it does not subserve the legislative objective of fair and equitable charges for natural gas.[417] But surely a rate is no less final, in terms of its operating capability, merely because it is subject to future revision. A fundamental precept of ratemaking is that rates may and should be changed whenever the exigencies of the public interest demand. And a vital function delegated to the Commission by the Natural Gas Act is the maintenance of the balance between producer, pipeline and consumer interests at the point of just and reasonable rates.[418] If the view espoused by the Commission in Opinion No. 565-A[419] were carried to its logical end, no rate set by the Commission could ever attain finality.

The 18.5-cent just and reasonable rate was established in Opinion No. 546 after a long and comprehensive exploration.[420] It earned, as we have said, full judicial approval.[421] Neither in Opinion No. 546-A nor in Opinion No. 565-A did the Commission find that the 18.5-cent area rate arrived at in Opinion 546 was unjust or unreasonable, or gravely doubtful in that respect. Rather, the investigation set in motion by Opinion 546-A and subsequently enlarged sought simply to determine what the just and reasonable test may require, if anything, in the way of modification of that rate.

[416] Natural Gas Act § 16, 15 U.S.C. § 717o (1970).

[417] See Part III(A), *supra*.

[418] See Part III(A), *supra*.

[419] See text *supra* at notes 385-87.

[420] Compare *City of Chicago* v. *FPC*, *supra* note 415, 147 U.S. App.D.C. at 321-22, 458 F.2d at 740-41.

[421] See text *supra* at notes 400-03.

In sum, the 18.5-cent rate differs little if any from any other rate that is inherently subject to change upon a suitable showing. The Commission's authority to alter or discard its prior rate orders is limited to changes which "it may find necessary or appropriate to carry out the provisions of" the Act.[422] In our view, the Commission is not free to disregard a rate competently determined in the past to be just and reasonable unless and until it finds that the rate is unjust or unreasonable in the present, or seriously suspect on that score. The Commission's revision power enables no more, and the legislative mandate for just and reasonable pricing[423] demands no less. We hold that neither the susceptibility of the 18.5-cent area rate to modification upon such a finding nor the ongoing administrative inquiry into the propriety of such a finding was adequate justification for the Commission's decision in Opinion No. 565-A to ignore it.

C. *The Standard For Producer Refunds*

In 1959, after the Commission announced its ill-fated Opinion No. 322 certificating the extension of Texas Eastern's pipeline to Rayne Field,[424] deliveries of gas from the producers' holdings therein commenced, and Texas Eastern began the purchase-price payments called for by the lease-sale contract. This court set Opinion No. 322 and its accompanying order aside in 1960,[425] and in Opinion No. 378 in 1963, the Commission asserted jurisdiction over the producers' sale.[426] In Opinion No. 565 in 1968, the Commission

[422] See text *supra* at note 416.

[423] See Part III(A), *supra*.

[424] *Texas Eastern Transmission Corp.* (Opinion No. 322), *supra* note 9. See Part I(A), *supra*.

[425] *Public Serv. Comm'n* v. *FPC*, *supra* note 22. See Part I(B), *supra*.

[426] *Texas Eastern Transmission Corp.* (Opinion No. 378), *supra* note 31, 29 F.P.C. at 252-57. See Part I(C), *supra*.

conventionalized the sale and directed producer refunds,[427] and in Opinion No. 565-A in 1969, the Commission deferred the refunds for an indefinite period.[428]

Throughout this lengthy period — a decade — the gas continued to flow through Texas Eastern's pipeline en route to consumers, and Texas Eastern continued its payments to producers on the schedule specified by the lease-sale contract. Since those remittances, as the Commission found in Opinion No. 565, greatly exceeded the amounts which Texas Eastern would have paid for the gas had it been delivered pursuant to a conventional sale arrangement,[429] the Commission's power to order producer refunds was incontestable. We realize, of course, that the early administrative treatment of the parties' transaction contributed to the occasion for financial adjustments between Texas Eastern and the producers, but the Commission's authority to require them nonetheless remained unimpaired.[430] "An agency, like a court, can

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[427] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 382-95. See Part III(D), *supra.*

[428] *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1087-88. See Part III(E), *supra.*

[429] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 387. See text *supra* at notes 205-10.

[430] In *United Gas Improvement Co.* v. *Callery Properties, supra* note 151, the court stated:

> While the Commission "has no power to make reparation orders," *Federal Power Comm'n* v. *Hope Natural Gas Co.*, 320 U.S. 591, 618, its power to fix rates under § 5 being prospective only, *Atlantic Refining Co.* v. *Public Service Comm'n, supra,* at 389, it is not so restricted where its order, which never became final, has been overturned by a reviewing court. Here the original certificate orders were subject to judicial review; and judicial review at times results in the return of benefits received under the upset administrative order. See *Securities & Exchange Comm'n* v. *Chenery Corp.*, 322 U.S. 194, 200-201.

382 U.S. at 229.

undo what is wrongfully done by virtue of its order,"[431] and "the Commission could properly conclude that the public interest required the producers to make refunds for the period in which they sold their gas at prices exceeding those properly determined to be in the public interest."[432] The problem for the Commission, rather, was the standard by which the amounts of the refunds were properly to be fixed, and that we must first define.

The Natural Gas Act, we haved noted, mandates just and reasonable rates for jurisdictional gas and declares that any other rate is unlawful.[433] As the Supreme Court has said.

> **Logically, this would seem to imply that to assure the "complete, permanent and effective bond of protection" [which the Act affords consumers "from excessive rates and charges"],[434] any rate permitted to be charged during the interim period before a just and reasonable rate can be determined must be accompanied by a condition rendering the producer liable for refunds down to the just and reasonable rate, should that rate prove lower than the initial rate specified in the certificate.**[435]

Although, as the Court acknowledged, the Commission apparently does not impose such a condition and reviewing

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[431] ***United Gas Improvement Co.* v. *Callery Properties, supra*** note 151, 382 U.S. at 229. See also *Democratic Cent. Comm.* v. *Washington Metropolitan Area Transit Comm'n*, ... U.S.App.D.C. ...., ..., 485 F.2d 786, 824-25 (1973); *Williams* v. *Washington Metropolitan Transit Comm'n*, 134 U.S.App.D.C. 342, 362-63, 415 F.2d 922, 942-43 (1968), *cert. denied,* 393 U.S. 1081 (1969).

[432] *United Gas Improvement Co.* v. *Callery Properties, supra* note 151, 382 U.S. at 229-30 (footnote omitted).

[433] See Part V(A), *supra.*

[434] *Atlantic Ref. Co.* v. *Public Serv. Comm'n, supra* note 10, 360 U.S. at 388.

[435] *FPC* v. *Sunray DX Oil Co., supra* note 151, 391 U.S. at 36.

courts have not insisted that it do so, [436] the need for a comparable course here seems irrefutable. If, at the time the refunds are to be made, the just and reasonable rate is readily available, there is hardly room for argument that some other criterion is ordinarily to be taken as the basis for computing the refunds. We have reasoned that absent an extraordinary situation, the in-line price cannot be utilized consistently with the Act as the initial price on a certificated sale when the just and reasonable rate for the gas has already been ascertained.[437] Since refunds serve the purpose of correcting prices which were too high, it follows that the excess over a predetermined just and reasonable rate is normally to be refunded. Only in the most unusual situation could a departure from that course be logically or legally justified.[438]

We are mindful of considerations which superficially might indicate a preference for the in-line price over the just and reasonable rate as the predicate for calculating refunds, but on analysis they do not support such a preference. Refunds must be made on the basis of the in-line price in lieu of a wait for the just and reasonable

[436] *Id.* at 37-40.

[437] See Part V(A)(1), *supra.*

[438] We recognize that an initial price may serve both as a ceiling for future transactions and as a floor for refunds on account of the past, and that the price ceiling and the refund floor "conceivably may serve significantly different ends." *FPC* v. *Sunray DX Oil Co., supra* note 151, 391 U.S. at 21-23, 24. As an example, that case pointed out that "in some situations a relatively high initial price might be thought desirable to encourage producers to develop new reserves but a lower refund floor might be deemed necessary to protect consumers." *Id.* at 24 n.11. At no time during this litigation has the Commission suggested that a properly set initial price for the producers' gas would not serve appropriately as the bench mark both for a reduction of rates to be charged and for refunds of excessive rates already paid, and, with the Commission's problem essentially a rectification of the past rather than a formula for the future, we perceive no basis upon which it could have.

rate,[439] but because the consumer's interest in speedy refunding — possible only on the basis of the in-line rate — predominates.[440] Initial pricing permissibly done at the in-line figure sets that figure as the refund base,[441] but because that is the preferred interpretation of the Act.[442] The use of in-line prices for purposes of refunds has been judicially approved, but in cases where no just and reasonable rate was extant.[443] On the other hand, where the just and reasonable rate has already been found, two courts have held that it might be employed.[444]

We have concluded that only a consideration subserving an overriding aspect of legislative policy affords adequate justification for a selection of the in-line price over an existing just and reasonable rate as the initial price at which a proposed gas sale is to be certificated.[445] No more can lesser considerations justify a refund base at the in-line price where the just and reasonable rate is at hand. We hold that an already established just and reasonable rate must be accepted as the foundation for producer refunds in the absence of paramount countervailing circumstances.

D. *The Treatment of Producer Refunds*

In Opinion No. 565, a majority of the Commission decided that the 18.5-cent rate set in the *Southern Louisiana*

[439] *United Gas Improvement Co.* v. *Callery Properties, supra* note 151, 382 U.S. at 229-30. See also *FPC* v. *Sunray DX Oil Co., supra* note 151, 391 U.S. at 37.

[440] See Part V(D)(1) *infra.*

[441] *FPC* v. *Sunray DX Oil Co., supra* note 151, 391 U.S. at 22-24.

[442] *Id.* at 24.

[443] *E.g., FPC* v *Sunray DX Oil Co,. supra* note 151, 391 U.S. at 36-40; *United Gas Improvement Co.* v. *Callery Properties, supra* note 151, 382 U.S. at 230.

[444] *Hunt Oil Co.* v. *FPC, supra* note 398, 424 F.2d at 986; *Phillips Petroleum Co.* v. *FPC, supra* note 221, 405 F.2d at 9.

[445] See Part V(A), *supra.*

Area Rate Proceeding[446] should serve as the basis for refunds by the producers on account of payments made to them by Texas Eastern after the date on which that rate went into effect.[447] The Commission majority further decided that the foundation for producer refunds to Texas Eastern because of deliveries prior to the effective date of the area rate should be the 1959 in-line price of 20 cents[448] — the price in vogue at the commencement of the deliveries.[449] The Commission reasoned:

> [U]nless we are to treat the present sale in the same manner as those contemporaneously contracted for and certificated at the in-line price of 20 cents per Mcf, we will in effect be punishing the producers for litigating their by no means frivolous legal and policy claims in the courts and before this Commission. This in our view would not only be inequitable, but would necessarily lead to unnecessary producer uncertainty when they choose to dedicate gas to the interstate market. Obviously, where their claims to special consideration are rejected they should not benefit by the passage of time in the course of their litigation. But where contemporary sales in the same area have been permanently certificated at in-line prices, approved by the courts, and used for both in-line and refund purposes, we do not believe that the exigencies of the timing of litigation on similar sales should lead to a different result.[450]

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[446] *Supra* note 53. See text *supra* at notes 69-75.

[447] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 383-84.

[448] *Id.* at 384-87.

[449] See text *supra* at note 355.

[450] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 385. The Commission added:

> Certificates in this proceeding cannot be issued without doing justice to all parties, including the consumers of gas and this requires consideration of what has already happened. The first time this proceeding was before us in 1959 we approved the transaction; the second time it was before us after remand in 1963 we condemned its form but afforded the parties opportunity to file new arrangements, and, on rehearing, denied we were requiring the parties to execute any particular kind of contract. In the present proceeding the lease-sale has again been presented to us. By this time a large part of the gas has been delivered and payment made. Various advantages are available to the parties — among others, tax benefits to the Producers, a flexible supply of gas for Texas Eastern, and, as provided below, if there is sufficient gas in the Field, a benefit to the consumers in purchase price free gas after the purchase price has been paid and Texas Eastern has been compensated for its outlays of funds. We have been partly responsible for this extended consideration of the lease-sale arrangement. When it first came before us, we might have denied it finally or conditioned it in such a way that our action would have satisfied the Court. Our original failure to consider the problem fully led to the first remand. On review of this history and the present relations of the parties we think it equitable to treat the Producers as though they had been granted a certificate when the delivery of gas commenced at the in-line price of 20 cents per Mcf.

Id. at 386.

[451] *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1081, 1087-88.

[452] *Id.*

In Opinion No. 565-A, however, the majority position of the Commission shifted; all payments above the just and reasonable rate, that opinion held, should be refunded.[451] But on the premise that the rate promulgated in the *Southern Louisiana Area Rate Proceeding* remained open to change, the Commission deferred producer refunds pending the establishment of a firm area rate.[452] The Commission explained:

> [T]he just and reasonable rates applicable to the Southern Louisiana area in which the Rayne Field is situated have not been fully determined, nor has it been determined whether refunds should be made by the producers in that area either for the periods before or after October 1, 1968. In these circumstances it is our opinion that the public interest precludes our ordering

> refunds to be paid by the Rayne Field producers at this time. The myriad problems confronting the Commission in coping with producer regulation render our task difficult and complex, at best. However, the one objective that must always be kept in sight is the need to provide fair and equal treatment for all of those regulated. It is essential, therefore, that the four producers involved in this proceeding should be afforded the same treatment as will be given to all other producers in Southern Louisiana. In this regard, we believe that the just and reasonable rates which ultimately flow out of any settlement, or any further proceedings in [the *Southern Louisiana Area Rate Proceeding*], should govern the level of payments in this case prior to October 1, 1968, as well as after that date.[453]

We cannot embrace fully the course of reasoning which the Commission majorities pursued in either of the two opinions. The standard for producer refunds, we have said, is the just and reasonable rate where that rate is available and use of another rate is not vindicated by some overriding facet of congressional policy.[454] Consequently, we have no difficulty with the holding in Opinion No. 565 that the producers must refund the excess of Texas Eastern's future payments over and above the just and reasonable rate determined in the *Southern Louisiana Area Rate Proceeding*,[455] nor with so much of the holding in Opinion No. 565-A as would constitute an established just and reasonable rate the basis for any and all producer refunds.[456] Since, however, as we have held, the Commissioner was not at liberty to discard the

[453] *Id.* at 1087-88.

[454] See Part V(B), *supra*.

[455] See text *supra* at note 447. While that holding was superseded by the decision in Opinion No. 565-A to defer all producer refunds, see Part II, *supra*, it was the only holding open to the Commission under the principles we have discussed. See Part V(C), *supra*.

[456] See text *supra* at note 451.

just and reasonable rate promulgated in the *Southern Louisiana Area Rate Proceeding*,[457] and as well for other reasons to be discussed,[458] we cannot accept the Commission's decision in Opinion No. 565-A to postpone refunding to such time as the area rate for Southern Louisiana producers might be reformulated. We conclude, too, that the considerations advanced in Opinions Nos. 565 and 565-A are legally insufficient to justify a refusal to employ the existing just and reasonable rate as the predicate for the producers' refunds.[459]

—(1) *The Deferral Of Producer Refunds*

Even assuming the nonexistence of any just and reasonable rate which might function as the basis for immediate refunds by the producers, that office could readily have been performed by the in-line price, which the Commission ascertained in this very proceeding.[460] The Supreme Court has made plain the Commission's authority to direct refunds predicated on the in-line price pending determination of the just and reasonable rate for the gas in question.[461] The Court has also made it clear that producer refunds, when found due, are to be ordered promptly, and are not to be postponed for a retroactive application of a just and reasonable rate yet to be determined.

In *United Gas Improvement Company* v. *Callery Properties*,[462] the Commission ordered producers to refund the difference between prices they charged and in-line prices

[457] See Part V(B) (2), *supra*.

[458] See Part V(D) (2), *infra*.

[459] See Part V(D) (1), *infra*.

[460] See text *supra* at note 353.

[461] *FPC* v. *Sunray DX Oil Co., supra* note 151, 391 U.S. at 37-38, 40-47; *United Gas Improvement Co.* v. *Callery Properties, supra* note 151, 382 U.S. at 226-28.

[462] *Supra* note 151.

at which the sales should originally have been conditioned. On review, the Fifth Circuit held, just as the Commission did in Opinion No. 565-A, that the measure of the refunds should have been the difference between the contract price and the just and reasonable rate subsequently to be fixed, and that refunds should be delayed until the latter was fixed.[463] The Supreme Court reversed the Fifth Circuit, stating:

> We have said elsewhere that it is the duty of the Commission, "where refunds are found due, to direct their payment at the earliest possible moment consistent with due process."[464] . . . These excessive rates have been collected since 1958; under the circumstances, the Commission was not required to delay this refund further.[465]

The considerably longer period over which the producers here have collected above the in-line price can hardly escape notice.[466]

We are mindful of the fact that in *Callery* and other cases it was the Commission that ordered refunds based on the in-line price, while in Opinion No. 565-A the Commission did just the opposite: it reversed the direction in Opinion No. 565 to that effect. We deem this difference insufficient to remove the case from the purview of the *Callery* ruling. The Commission was not merely at liberty to require immediate refunds but, where refunds are due,

[463] *Callery Properties* v. *FPC*, 335 F.2d 1004, 1018-20 (5th Cir. 1964), *cert. denied sub nom., Frankel* v. *FPC*, 382 U.S. 985 (1966).

[464] Quoting *FPC* v. *Tennessee Gas Transmission Co.*, 371 U.S. 145, 155 (1962).

[465] 382 U.S. at 230.

[466] Compare also *FPC* v. *Tennessee Gas Transmission Co., supra* note 464, 371 U.S. at 154.

it also had "the duty . . . to direct their payment at the earliest possible moment consistent with due process."[467] That duty charts the only course in keeping with the purpose of the Act "to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges." [468] No more than the Fifth Circuit in *Callery* could the Commission defer refunds demanded in the public interest to the uncertain time at which a just and reasonable rate might be forthcoming.

In his Phase II decision, the presiding examiner found that through 1967 Texas Eastern had paid the producers $21.8 million more than gas deliveries at the in-line price would have brought — a figure which with interest increased to $31.4 million.[469] In Opinion No. 565, the Commission adopted the examiner's finding and directed refunds,[470] and nothing in Opinion No. 565-A is at variance with that finding. Beyond that, the refund liability ascertained in Opinion No. 565 had endured, on a gradually increasing scale, over an eight-year period during which Texas Eastern had passed the greater portion of the price excesses on to consumers as a part of its cost of service.[471] These circumstances support vividly the Commission's resolve in Opinion No. 565 to direct refunds, and point convincingly to the error in the Commission's decision in Opinion No. 565-A to postpone the long overdue refunds even longer.

[467] *FPC* v. *Tennessee Gas Transmission Co., supra* note 464, 371 U.S. at 155. *Accord*, *FPC* v. *Sunray DX Oil Co., supra* note 151, 391 U.S. at 37; *United Gas Improvement Co.* v. *Callery Properties, supra* note 151, 382 U.S. at 230.

[468] *Atlantic Ref. Co.* v. *Public Serv. Comm'n, supra* note 10, 360 U.S. at 388. See also Part V(A), *supra*.

[469] *Texas Eastern Transmission Corp., supra* note 43, 42 F.P.C. at 460-61 (examiner's Phase II decision).

[470] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 393-405.

[471] See Part VI(G), *infra*.

The Commission assigned two reasons for its decision to put off all producer refunds while the area rate for Southern Louisiana was undergoing further investigation. The first was the recurring thesis that the 18.5 cent area rate for Rayne Field gas had not been finally determined.[472] We have already examined that premise and found it to be erroneous.[473] And with the just and reasonable area rate — at least for the time being — available, and the gross excess in producer receipts above that rate evident,[474] it is clear enough that the Commission's concern that the producers might not have to make refunds[475] was unfounded.

The Commission's second reason was that a deferral of refunds would foster equality of treatment among Southern Louisiana producers,[476] presumably because all producers under an obligation to refund would do so on the basis of the area rate which the Commission would eventually formulate. But, obviously, with a just and reasonable rate of 18.5 cents already in being,[477] the highly desirable goal of equal treatment could have been achieved simply by enforcing it uniformly among the producers.[478] Moreover, we can perceive no significant difference between the Commission's action here and the Fifth Circuit's postpone-

[472] See text *supra* at note 453.

[473] See Part V(B) (2), *supra*.

[474] See text *supra* at note 469. There we point out the large excess of payments to prducers over the in-line rate. That excess of course, is even greater in reference to the 18.5-cent just and reasonable area rate.

[475] See text *supra* at note 453.

[476] See text *supra* at note 453.

[477] See Part V(B) (2), *supra*.

[478] Any inequality of which the Commission speaks is manifestly the result of suspensions of the 18.5-cent just and reasonable rate pending completion of its reexamination of that and other area rates, a course upon which we do not put the stamp of approval. See Part V(B) (2), *supra*.

ment of producer refunds in *Callery*[479] to the day that a just and reasonable rate would become established.[480] Such a postponement might give the assurance the Commission sought,[481] but sacrifices the superior interest of consumers in prompt refunds.[482] By its decision to delay refunds here, the Commission misconceived its consumer-protection functions under Section 7 as enunciated by the Supreme Court in *CATCO*.[483] We can no more condone the deferral here than the Supreme Court could in *Callery*.[484]

— (2) *The Amounts Of Producer Refunds*

The Commission, then, should have directed immediate producer rate refunds in Opinion No. 565-A, as it had earlier done in Opinion No. 565. That is not to say that Opinion No. 565 employed the correct standard for measuring the amounts of the refunds. We are satisfied that in part it did not.[485]

It will be recalled that in Opinion No. 565 the Commission selected the 20-cent in-line price as the foundation for refunds on payments to producers prior to October 1, 1968,

[479] *United Gas Improvement Co.* v. *Callery Properties*, *supra* note 151.

[480] See text *supra* at notes 462-65.

[481] The extent to which it could do so might depend in part upon whether initial prices allowed producers were all fixed at the same level, since those prices established refund floors. See note 171, *supra*.

[482] At best, the refunding process is "somewhat illusory in view of the trickling down process necessary to be followed, the incidental cost of which is often borne by the consumer, and in view of the transient nature of our society which often prevents refunds from reaching those to whom they are due". *FPC* v. *Tennessee Gas Transmission Co.*, *supra* note 464, 371 U.S. at 154-55 (footnote omitted).

[483] *Atlantic Ref. Co.* v. *Public Serv. Comm'n*, *supra* note 10, 360 U.S. at 338-92. See Part III(A), *supra*, and text *supra* at notes 278-303.

[484] See text *supra* at notes 462-65.

[485] For the purpose, we assume, without deciding, that so much of Opinion No. 565 was not nullified by the supersession of that opinion by Opinion No. 565-A.

the effective date of the 18.5-cent just and reasonable area rate, and at the 18.5-cent rate on payments made thereafter.[486] The problem, as we see it, is with the use of the in-line rate at all. As we have said, an existent just and reasonable rate furnishes the exclusive basis for producer refunds unless the use of another basis is indicated by some overriding consideration of legislative policy.[487] The Commission endeavored to justify utilization of the in-line rate for the period prior to establishment of the just and reasonable rate on the ground that it would enable an equitable treatment of all Southern Louisiana producers and promote certainty as to the initial price at which they might dedicate their gas to the interstate market.[488] But as we have previously pointed out, equality of treatment among producers could have been achieved as readily by uniform application of the just and reasonable rate to Southern Louisiana producers.[489] And to the extent that stability of the initial price obtainable by producers pondering a choice between interstate and intrastate markets was legitimately a competing consideration,[490] it would have been as fully assured by adoption of the just and reasonable rate as the initial price payable on certification.[491]

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486 See text *supra* at notes 446-50.

487 See Part V(C), *supra*.

488 See text *supra* at note 453.

489 See text *supra* at notes 477-78. In Opinion No. 565-A, the Commission recognized as much but erroneously decided that the just and reasonable rate was yet to be finalized. See text *supra* at note 453.

490 *FPC* v. *Sunray DX Oil Co.*, *supra* note 151, 391 U.S. at 44-46.

491 Nor can we accept the Commission's reasoning that the in-line price should operate as the basis for refunds on payments prior to establishment of the just and reasonable rate to avoid "punishing the producers for litigating their" claims. See text *supra* at note 450 and accompanying note. The difficulty arises, not because the producers engaged in litigation, but because they engaged in field operations before the litigation ended. The hazards of commencing operations on the strength of a contested certification that had not run its course through the court is obvious. See *United Gas Improvement Co.* v. *Callery Properties*, *supra* note 151, 382 U.S. at 225, 229-30. Compare *FPC* v. *Sunray DX Oil Co.*, *supra* note 151, 391 U.S. at 44-46; *FPC* v. *Tennessee Gas Transmission Co.*, *supra* note 464, 371 U.S. at 146-47.

We cannot accept the grounds the Commission put forth in Opinion No. 565 as considerations of a caliber sufficient to outweigh the clear congressional preference for just and reasonable rates when available as indices for initial pricing in Section 7 certification proceedings. Nor can we accept the reasons advanced in Opinion No. 565-A as adequate justification for the Commission's decision to defer refunding by the producers. We hold that the Commission was legally bound to order the refunds forthwith, and to predicate them upon the just and reasonable rate of 18.5 cents previously established in the *Southern Louisiana Area Rate Proceeding*.

VI. Flow-Through of Rate Reductions and Refunds

The issues remaining for our determination concern the extent to which rate reductions and refunds required of the producers in Texas Eastern's favor should be passed on to its customers,[492] including the treatment, in relation to refunds, that should be given to Texas Eastern's investment in Rayne Field.[493] The Commission dealt with and

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492 See note 552, *infra*.

493 The investment consists in unrecovered amounts which Texas Eastern spent to acquire the working interest in Rayne Field pursuant to the lease-sale contract. See *Texas Eastern Transmission Corp.*, *supra* note 43, 42 F.P.C. at 461-62 (examiner's Phase II decision). After consummation and certification of the lease-sale transaction in 1959, Texas Eastern treated its payments to producers partly as capital items and partly as expenses as the field produced gas. *Id.* From December 1, 1959, onward, the rates at which Texas Eastern supplied gas to its distributor-customers reflected some of this expense as a part of its cost of service. *Id.* As of December 31, 1967, Texas Eastern had recorded on its books a gross investment of $76,665,683 and a net investment of $20,882,996 in Rayne Field. *Id.* at 562. Texas Eastern also asserts that it expended an additional $3,040,821 in connection with the Rayne Field leaseholds for which it has not been reimbursed. *Id.*

disposed of these matters in Opinion No. 565,[494] but by Opinion No. 565-A deferred them for future consideration because their decision depended both upon the fact and the size of producer reductions and refunds, which Opinion No. 565-A left unsettled.[495] We have discussed and resolved the latter problems, concluding that the producers must reduce their rates for the future and must refund the amounts charged above just and reasonable rates in the past.[496] The flow-through question thus returns to the fore.

In his Phase II decision, the presiding examiner directed Texas Eastern to deposit the customer refunds which he ordered[497] in escrow pending their disposition by the Commission in a later proceeding.[498] In consequence of the reduction of producer rates,[499] the examiner also directed Texas Eastern to lower the commodity charge in its systemwide rates by 0.2 cents per Mcf.[500] In Opinion No. 565, the Commission deviated from the examiner on both counts, on grounds now to be discussed.

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494 *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 395-402, 405-06.

495 *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1088-89, 1091.

496 See Part V, *supra*.

497 See *Texas Eastern Transmission Corp., supra* note 43, 42 F.P.C. at 464, 467 (examiner's Phase II decision).

498 *Id.* at 464-65, 467.

499 It will be recalled that the reduction envisioned by the examiner and by the Commission in Opinion No. 565 was to 20 cents per Mcf from the beginning of production until establishment of the initial area rate for Southern Louisiana, and thereafter at the just and reasonable rate for the area, *Texas Eastern Transmission Corp., supra* note 16, 42 F.P.C. at 447-52 (examiner's initial decision), *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 393-95; and that we have held that, for purposes of computing producer refunds, the reduction should have been to the just and reasonable rate throughout. See Part V, *supra*.

500 *Texas Eastern Transmission Corp., supra* note 43, 42 F.P.C. at 465-66 (examiner's Phase II decision).

A. *The Treatment of Rate Reductions in Opinion No. 565*

Before the Commission, Texas Eastern argued that the Commission had no authority under Section 7 of the Act[501] to revise systemwide rates which previously had been found to be just and reasonable.[502] The Commission deemed it unnecessary to address that contention. Texas Eastern had filed in another docket, under Section 4(a),[503] a rate increase which included as a predicate its Rayne Field costs, and that filing was then in hearing before an examiner.[504] The Commission felt that in those circumstances Opinion No. 565 "may properly provide the basis for interim action in" the other docket.[505] Accordingly, the Commission ordered "Texas Eastern to file substitute rates to reflect any reduction in costs arising from these proceedings and in accordance with this opinion."[506] The Commission specified that

> As long as Texas Eastern is paying the producers for the gas and until the purchase price of \$134,395,700 has been paid, and from then until complete amortization of the Rayne Field balances on Texas Eastern's books,[507] Texas Eastern's rates shall continue to reflect the cost of the Rayne Field gas at the applicable area rate, now 18.5 cents per Mcf. However, when the amortization of the Rayne Field balances has been completed, Texas Eastern, providing it is still selling gas from Rayne Field, shall file new rates to reflect the fact that it is no

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501 15 U.S.C. § 717f (1970).

502 *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 400.

503 15 U.S.C. § 717c(a) (1970).

504 *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 400.

505 *Id.*

506 *Id.* at 400-01.

507 See note 493, *supra*.

longer paying the producers but is merely paying royalties and other expenses.[508]

B. *The Treatment of Refunds in Opinion No. 565*

On the subject of producer refunds, the examiner had felt bound by the Commission's Opinions Nos. 540 and 540-A, rendered in earlier litigation involving Texas Eastern.[509] Producers had collected rate increases from Texas Eastern but they were subsequently disallowed by the Commission, and a producer refund of some $10 million was generated as a result. Texas Eastern had not passed the increases on to its customers in the form of higher rates of its own. Texas Eastern sought the refund for itself, but the Commission held that the refund should flow through to Texas Eastern's distributor-customers for the ultimate benefit of the consuming public.[510] Reversing past practice,[511] the Commission established prospectively the principle that unless a pipeline filed a rate increase[512] tracking a supplier increase, it could not later assert a claim to a refund created by

[508] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 401.

[509] *Texas Eastern Transmission Corp.* (Opinion No. 540), 39 F.P.C. 630 (1968), *rehearing denied,* (Opinion No. 540-A), 40 F.P.C. 62 (1969), *aff'd sub nom. Texas Eastern Transmission Corp.* v. *FPC*, 414 F.2d 344 (5th Cir. 1969). See also *Texas Eastern Transmission Corp.* v. *FPC*, 357 F.2d 232 (5th Cir. 1966).

[510] *Texas Eastern Transmission Corp.* (Opinion No. 540), *supra* note 509, 39 F.P.C. at 634-48; *Texas Eastern Transmission Corp.* (Opinion No. 540-A), *supra* note 509, 40 F.P.C. at 63-65.

[511] Previously, on disallowance of a supplier-rate increase, the Commission had permitted pipelines to retain the refunds unless they had increased their own rates in response to supplier increases. In the latter event, the Commission required the pipelines to flow the refund through to customers. See *Texas Eastern Transmission Corp.* (Opinion No. 540), *supra* note 509, 39 F.P.C. at 646-47; *Texas Eastern Transmission Corp.* (Opinion No. 540-A), *supra* note 509, 40 F.P.C. at 63-64.

disallowance of the supplier increase.[513] Because of the prospectivity of this new requirement, it did not apply to Texas Eastern; but because Texas Eastern had nonetheless earned more than a reasonable margin of return,[514] the Commission directed a flow-through of the entire $10 million to its customers.[515]

In the proceeding now before us, Texas Eastern did not file a tracking rate increase. The examiner found that Texas Eastern "earned a fair return despite having paid too much for Rayne Field gas,"[516] and held that "[t]he reduction in its cost of gas should go to its customers."[517] The examiner further concluded that Texas Eastern's net investment of more than $20 million in Rayne Field[518] should be charged off to surplus.[519] In Opinion No. 565, however, the Commission deemed Opinion Nos. 540 and 540-A distinguishable:

> There is no supplier rate increaese involved here, the annual expense of which Texas Eastern could have passed on to its customers through a rate increase filing, had it believed the rate increase could be justified. Instead, under the lease-sale (which will remain in existence, though gas payments therefrom are conventionalized), the down payment, note pay-

[512] Pursuant to § 4(c), (d) of the Act, 15 U.S.C. § 717c(c), (d) (1970).

[513] *Texas Eastern Transmission Corp.* (Opinion No. 540), *supra* note 509, 39 F.P.C. at 638-43.

[514] *Texas Eastern Transmission Corp.* (Opinion No. 540), *supra* note 509, 39 F.P.C. at 642-43; *Texas Eastern Transmission Corp.* (Opinion No. 540-A), *supra* note 509, 40 F.P.C. at 64.

[515] *Texas Eastern Transmission Corp* (Opinion No 540), *supra* note 509, 39 F.P.C. at 642-43, 648-49.

[516] *Texas Eastern Transmission Corp., supra* note 43, 42 F.P.C. at 463 (examiner's Phase II decision).

[517] *Id.*

[518] See note 493, *supra.*

[519] *Texas Eastern Transmission Corp., supra* note 43, 42 F.P.C. at 462-63 (examiner's Phase II decision).

ments and most of the other capital expenditures were reasonably treated by Texas Eastern as a capital investment, and as such in any rate case Texas Eastern could not have recovered anything more than the approved rate of annual return on such expenditures, depreciation, depletion and amortization, and certain expenses and taxes.[520]

In consequence, the Commission held that it "should not prescribe a complete flow-through by Texas Eastern of the refunds from the Producers."[521] On the other hand, to the Commission it was "clear that Texas Eastern could have filed rates including Rayne Field costs on the above basis[522] for the entire refund period."[523]

The Commission reasoned:

> A complete flow-through of the producer refunds would put Texas Eastern in the position of paying too much for part of the Rayne Field gas without any relief and then paying the just and reasonable price for additional gas until the Producers shall have received the full purchase price of \$134,395,700, so that Texas Eastern would end up paying some \$21,000,000 more than it had originally contracted

[520] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 395.

[521] *Id.*

[522] The reference here is obviously to "depreciation, depletion and amortization, and certain expenses and taxes." See text *supra* at note 520.

[523] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 395. The Commission pointed out, *id.* at 395-96, that at the beginning of Texas Eastern's Rayne Field operations on July 27, 1959, there were effective settlement rates in Docket No. G-12706, arising from a filing on May 10, 1957, which rates were not, but could have been, supported by Rayne Field costs; that from December 1, 1959, until January 1, 1964, there were in effect rates derived by a settlement in Docket No. G-18841, on the basis of computations which did include Rayne Field costs, of Texas Eastern's rate-increase filing of May 28, 1959, *Texas Eastern Transmission Corp.*, 25 F.P.C. 172 (1961); that on January 1, 1964, there became effective a voluntary rate reduction filed by Texas Eastern in Docket No. FP64-36 to reflect a decrease in corporate income tax; and that still another change in Texas Eastern's rates became effective on June 1, 1965, as a result of conferences with the Commission's staff, in Docket No. RP65-59, and Rayne Field costs were again included, see *Texas Eastern Transmission Corp.*, 34 F.P.C. 98, 100 (1965), *Texas Eastern Transmission Corp.*, 34 F.P.C. 732, 733 (1965).

> to pay. However, to the extent the excessive payments in the years from 1959 to the present have fallen on its customers, Texas Eastern has already been reimbursed and the customers should receive a flow-through refund of that amount.[524]

Looking then to the evidence, the Commission found that, on the basis of the excess of the actual per-Mcf cost of the gas, by virtue of the lease-sale arrangement, over an in-line price of 20 cents per Mcf,[525] Texas Eastern's customers had paid \$13,848,919 of its Rayne Field costs through 1967.[526] To this the Commission added \$6,080,371, representing an allocable part of the interest which the producers were to pay Texas Eastern,[527] making a refund to its customers of \$19,929,290 as of the end of 1967.[528] The amount of the refund, the Commission ruled, was to be brought up to date on the basis of 20 cents per Mcf of gas to October 1, 1968, and 18.5 cents thereafter, together with added interest.[529] The Commission directed Texas Eastern to calculate the total amount of the refund, subject to its approval, and to

[524] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 396

[525] It will be remembered that in Opinion No. 565 the Commission held that producer refunds should be based on the in-line price of 20 cents per Mcf, a conclusion with which we disagree. See Part V(C), (D)(2), *supra*.

[526] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 396-98.

[527] See text *supra* at notes 469-70.

[528] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, F.P.C. at 398.

[529] *Id.*

hold that amount for flow-through on the Commission's further order.[530]

Thus the Commission arrived at the point at which it was able to address the investment which Texas Eastern had made in Rayne Field while the lease-sale arrangement was in vogue. At the end of 1967, the net investment was $20,882,996,[531] which Texas Eastern proposed to recoup in its entirety from the amount of the producers' refund.[532] The Commission accepted neither this proposal nor the examiner's conclusion that Texas Eastern should lose the whole investment through a charge-off to surplus.[533] Instead, the Commission took the view that the balance of the refund remaining after customer flow-through should be used to reduce the investment on Texas Eastern's books.[534] After flow-through to customers of $19,929,290[535] of the $31,449,000 refund, principal and interest,[536] there remained $11,519,710[537] for that application, with a consequent reduction of the net investment to $9,303,286.[538] That amount, the Commission

[530] *Id.*

[531] *Id.* at 398. See also note 493, *supra.*

[532] *Id.* See also note 538, *infra.*

[533] See text *supra* at notes 516-19.

[534] *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 399-400.

[535] See text *supra* at notes 516-19.

[536] See *Texas Eastern Transmission Corp., supra* note 43, 42 F.P.C. at 460-61 (examiner's Phase II decision).

[537] Broken down, this figure represents the residue of $8,005,081 in principal and $3,514,629 in interest due from the producers. *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 399.

[538] *Id.* In addition to the investment balance of $20,882,996, Texas Eastern also sought reimbursement out of producer refunds of $3,040,821 in previously unrecovered and uncapitalized expenditures. *Id.* at 398. See also note 493, *supra.* The Commission found that this additional sum "results principally from the facts that amounts expended in connection with the Rayne Field were not included among the costs underlying Texas Eastern's rates prior to

said, Texas Eastern might keep on its books, other than as a rate-base asset,[539] for amortization from Rayne

December 1, 1959, when the settlement rates in Docket No. G-18841 became effective, [*Texas Eastern Transmission Corp., supra* note 523,] 25 F.P.C. 172." *Id.* at 399. To the Commission, it was "clear that Texas Eastern cannot now claim costs that were not covered by rates filed on May 10, 1957, in Docket No. G-12706, effective as its filed rates until December 1, 1959, and eventually covered by the settlement of January 25, 1961 ([*Texas Eastern Transmission Corp., supra* note 523,] 25 F.P.C.172)." *Id.* See note 523, *supra.*

[539] On this score the Commission said

> The balance of $9,303,286 brought up-to-date, may remain on Texas Eastern's books if the company desires, but it shall be recorded in oth r than "rate base" accounts. In some ways this represents a prepayment for gas, and we have allowed pipelines to earn a return on prepayments. See *Michigan Wisconsin Pipe Line Company,* 27 F.P.C. 449, 455 (1962), cited by Texas Eastern and [*Transwestern Pipeline Co.* (Opinion No. 500)], 36 F.P.C. 176, 216 (1966). However, prepayments ordinarily occur where the pipeline under a conventional contract has taken less than the required quantity of gas. Here we have an uncommon situation involving large payments, as part of the basic transaction calling for such payments in the early years of the contract. We think, therefore, that the cost of Rayne gas which will be reflected in future rates to Texas Eastern's customers should not be increased above the 18.5 cent just and reasonable level by permitting Texas Eastern to add the Rayne Field balances to its rate base and earn a return on them.

Texas Eastern Transmission Corp. (Opinion No. 565), *supra* note 16, 42 F.P.C. at 399.

[540] The Commission elucidated:

> [W]e do not think Texas Eastern should be penalized for entering into this transaction if it can be made whole without loss to its customers. Therefore it may compute a return on the Rayne Field balances and accumulate it each year. As already discussed, Texas Eastern on the basis of the 18.5 cent price per Mcf shall complete paying the full purchase price of $134,395,700, including the return to the Producers of the refunds they have made ($21,854,000 brought up-to-date). At that point, provided the Field is still productive, we shall require that Texas Eastern use the difference between what it then must pay for gas (royalties, taxes, and other costs less credits) and what it would have to pay under the applicable area price to amortize the balance. Texas Eastern will incur

Field gas sales to the extent possible after Texas Eastern completes payment to the producers of the $134 million contract price.[540]

C. *The Impact of Opinion No. 565-A*

Such was the Commission's analysis and disposition of the flow-through issue in Opinion No. 565, but in Opinion No. 565-A it was completely discarded. Since, in the latter opinion, a 4-1 majority of the Commission ruled that no rate reduction or refund by the producers to Texas Eastern should be ordered before the area rate for Southern Louisiana underwent further consideration,[541] there was, of course, no reduction or refund to be passed along.[542] For the same reason, neither a decision on flow-through nor a concomitant ruling on the investment balance was deemed possible.[543] So, over Commissioner

> the risk that there will not be enough gas from the field to enable it to completely amortize the balance, but this is a consequence of the lease-sale type of contract. It may be protected, in part, by the Producers' reserve guarantee if the certificate issued by us is satisfactory to the Producers.

Id. at 399-400.

541 See Parts V(B), (D), *supra.*

542 The Commission held, moreover, that "it would not now be in the public interest to require Texas Eastern to file new rates to track the producer rate filing here ordered." *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1089. "To require Texas Eastern to make a filing now," the Commission said, "might result in only a temporary reduction to its customers, and thus would bring about only a condition of instability without commensurate benefits." *Id.* "However," the Commission added, "in deferring any rate filing by Texas Eastern to track the producer rate filing we shall require that Texas Eastern be subject to refund to the extent its present rates are higher than they would be if they reflected a 20-cent Rayne Field producer rate. . . . Texas Eastern, of course, would also remain subject to our requiring a flow-through of producer refunds if that should be deemed appropriate." *Id.*

543 *Id.* at 1088.

O'Connor's dissent.[544] definitive action on these matters was deferred,[545] and the deferral was left standing by the order denying rehearing of Opinion No. 565-A.[546]

D. *The Present Problems*

There is, in the litigation before us, no demurrer to the Commission's jurisdiction to deal, as between Texas Eastern and the customers to which Opinion No. 565 applies, with any rate reductions or refunds receivable by Texas Eastern from the producers.[547] The gas in question entered Texas Eastern's pipeline at Rayne Field in Louisiana, and was transmitted and sold to distributors in other states for purposes of resale to the public.[548] No less than the producers' sales of the gas to Texas Eastern[549] were Texas Eastern's sales of the gas to those distributors activities within the regulatory domain of the Commission.[550] No narrower than the Commis-

544 *Id.* at 1091-96.

545 *Id.* at 1088-89, 1091.

546 *Texas Eastern Transmission Corp., supra* note 100 (order denying rehearing).

547 While Texas Eastern has a minuscule group of nonjurisdictional customers of Rayne Field gas, it seems clear that the refunding directives of Opinion No. 565 were not intended to affect them. See *Texas Eastern Transmission Corp.* (Opinion No. 540), *supra* note 509, 39 F.P.C. at 643-45; *Texas Eastern Transmission Corp., supra* note 43, 42 F.P.C. at 464 (examiner's Phase II decision).

548 See *Texas Eastern Transmission Corp., supra* note 9, 21 F.P.C. at 872-73, 880-81 (examiner's decision); *Texas Eastern Transmission Corp.* (Opinion No. 540), *supra* note 509, 39 F.P.C. at 643-45.

549 See Parts I(B), (C), *supra.*

550 Natural Gas Act §§ 1(b), 2(6)-(7), 15 U.S.C. §§ 717(b), 717a(6)-(7) (1970). See also *FPC* v. *Amerada Petroleum Corp.,* 379 U.S. 687 (1965); *California* v. *Lo-Vaca Gathering Co.,* 379 U.S. 366 (1965); *FPC* v. *Interstate Natural Gas Co.,* 336 U.S. 577, 580-81 (1949); *Illinois Natural Gas Co.* v. *Central Ill. Pub. Serv. Co.,* 314 U.S. 498, 502-09 (1948). See also *Central States Elec. Co.* v. *City of Muscatine,* 324 U.S. 138 (1945).

sion's jurisdiction to prescribe rate reductions and refunds in the one case[551] was its jurisdiction to allocate the resulting benefits in the other.[552] And no less potent than the Commission's authority to allocate such benefits in ratemaking proceedings[553] was its authority to do so in Section 7 proceedings.[554] The questions we encounter

[551] See Parts V(A), (C), *supra*.

[552] The Commission's authority over flow-through of rate reductions and refunds extends only to those to be made by pipelines to jurisdictional customers. Those to be made by distributor-customers to ultimate customers are matters for state regulation. See *FPC* v. *Tennessee Gas Transmission Co., supra* note 464, 371 U.S. at 155 n.9; *FPC* v. *Interstate Natural Gas Co., supra* note 550, 336 U.S. at 580-81; *Central State Elec. Co.* v. *City of Muscatine, supra* note 550, 324 U.S. at 144-46. This the Commission has realized, but it has assumed, properly we think, that state regulatory agencies will discharge their own responsibilities to benefit ultimate consumers. *Texas Eastern Transmission Corp.* (Opinion No. 540), *supra* note 509, 39 F.P.C. at 638. As the Fifth Circuit has stated:

> The Commission's view [is] that it [is] serving the statutory purpose of the Act of benefiting ultimate consumers by placing the refunds within the jurisdiction of the state regulatory authorities so as to place them in position to benefit the ultimate consumers. The Commission could not guarantee benefits for the ultimate consumers but absent its new policy there would be no way to benefit the ultimate consumers. . . . [This is] an approach to effective Federalism within the framework and dictates of the Act.

Texas Eastern Transmission Corp. v. *FPC*, *supra* note 509, 414 F.2d at 350.

[553] *E.g., FPC* v. *Tennessee Gas Transmission Co., supra* note 464, 371 U.S. at 151-55.

[554] Although § 7, unlike §§ 4(e) and 5(a), does not expressly confer upon the Commission authority to reduce unjust or unreasonable rates, we have seen that the Commission's power to condition § 7 certificates of public convenience and necessity upon specified maximum rates is well established. See Parts III(A), V(A), *supra*. And an exercise of the conditioning authority with respect to the certificate sought by Texas Eastern was undoubtedly as much the Commission's prerogative as was its exercise with respect to the certificate requested by the producers. *E.g., Central Illinois Pub. Serv. Co.* v. *FPC*, 338 F.2d 682 (7th Cir. 1964). Similarly, while § 7, like § 5(a) but unlike § 4(a), contains no provision specifically referable to refunds, we are satisfied that that makes no difference. Just as the Commission may, in § 7 proceedings, demand refunds by producers to pipelines, see Part V(C), *supra*, it may exert the same power against pipelines in favor of their customers. *FPC* v. *Tennessee Gas Transmission Co., supra* note 464, 371 U.S. at 146-47, 154-55; *Texas Eastern Transmission Corp.* v. *FPC*, 470 F.2d 757, 759-60 (5th Cir. 1972); *Texas Eastern Transmission Corp.* v. *FPC, supra* note 509, 414 F.2d at 347-49.

The basis of the Commission's § 7 power in each situation—rate reductions and refunds—is its responsibility to foster, through invocation of its authority to condition certificates in the public interest, see note 151, *supra*, "the overriding purpose of the Natural Gas Act to protect consumers in their purchase of gas to the end of keeping rates as low as possible." *Texas Eastern Transmission Corp.* v. *FPC, supra* note 509, 414 F.2d at 347. See also Part V(A), *supra*. "The history of the Natural Gas Act is one of interstitial construction," *id.* at 348, and in no small measure the filing of the interstices within the outer limits of the Act brightens the prospect that it will achieve the goals Congress envisioned. See *Phillips Petroleum Co.* v. *Wisconsin, supra* note 6; *Atlantic Ref. Co.* v. *Public Serv. Comm'n, supra* note 10; *FPC* v. *Sunray DX Oil Co., supra* note 151.

in connection with such allocations are not questions of Commission power, but are of an entirely different order.

We have held that the Comission cannot defer longer the rate reductions and refunds by the producers to Texas Eastern which conventionalization of the parties' lease-sale agreement demands.[555] In consequence, we have rejected the directives of Opinion No. 565-A and its accompanying order that disposition of reduction and refund issues be postponed.[556] We have also held that the producer refunds are to be computed on the basis of the just and reasonable rate of 18.5 cents per Mcf from the time at which Texas Eastern began to transmit the gas it drew from Rayne Field.[557] For that reason, we have disapproved so much of Opinion No. 565 as would have predicated the refunds on the 20-cent in-line price for slightly more than

[555] See Parts V(A), (B)(2), (C), (D)(1), *supra*.

[556] See Parts V(C), (D)(1), *supra*.

[557] See Parts V(C), (D)(2), *supra*.

the first nine years of the production period.[558] These adjudications necessitate resolution of the problems related to allocation of the benefits of the rate reductions and refunds as between Texas Eastern and its customers.

We do not approach these problems on the broad premise that invalidity of an administrative decision undertaking to change an earlier administrative decision invariably reinstates the earlier decision. We realize that the agency may legally have a choice as to the action it will take in the matter, and that a court may not be able to say that the agency, had it known that the later decision would not pass judicial muster, would have left the earlier decision as its final action. On the other hand, it is obviously unnecessary to indulge further administrative consideration of problems as to which but one solution is legally open.

The Commission's power to modify its prior orders, we have said, is confined to changes which "it may find necessary or appropriate to carry out the provisions" of the Act.[559] Save as to the amounts of the allocations,[560] Opinion No. 565's treatment of flow-through of the rate reductions and refunds, we find, is fully consistent with policies fundamental to the Act.[561] On the other hand, deferment of flow-through issues — like deferment of the rate-reduction and refund issues themselves — which the Commission majority decreed in Opinion No. 565-A, we further find, in no way serves to foster the provisions or purposes of the Act.[562] We ultimately conclude, then, that Opinion No. 565, insofar as it effectuates legal mandates, is to be sustained as the

[558] See Part V(D)(2), *supra*.
[559] See text *supra* at note 416.
[560] See Parts VI(E), (F), (G), *infra*.
[561] See Parts VI(E), (F), *infra*.
[562] See Parts VI(E), (F), *infra*.

Commission's action in this litigation; and in remaining respects we remand to the Commission for further consideration in accordance with this opinion.

E. *The Standards for Flow-Through of Rate Reductions and Refunds*

The principles governing flow-through by a pipeline of rate reductions and refunds by its suppliers trace their origin to policy ingrained in the regulatory scheme of the Natural Gas Act. Since we have already had occasion to discuss that topic in another context,[563] a brief highlighting will suffice here. The great objective of the Act was the underwriting of "just and reasonable rates to the consumers of natural gas."[564] The clear "intention of Congress" was "that natural gas shall be sold in interstate commerce for resale for ultimate public consumption . . . at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest."[565] The design of the Act is to "afford consumers a complete, permanent and effective bond of protection from excessive rates and charges."[566] It is the Commission's responsibility in Section 7 proceedings to exercise "control over the conditions under which gas may be initially dedicated to interstate use,"[567] to the end that "full protection of the public interest"[568] will be afforded.

[563] See Part V(A), *supra*.
[564] See text *supra* at note 363, quoting *Atlantic Ref. Co. v. Public Serv. Comm'n*, *supra* note 10, 360 U.S. at 388.
[565] See text *supra* at note 372, quoting 52 Stat. 825 (1938). See also text *supra* at note 373.
[566] See text *supra* at note 368, quoting *Atlantic Ref. Co. v. Public Serv. Comm'n*, *supra* note 10, 360 U.S. at 388.
[567] See text *supra* at note 370, quoting *id.* at 389.
[568] See text *supra* at note 379, quoting *id.* at 392.

The import of these considerations for flow-through of rate reductions and refunds to pipelines is evident. The rightful beneficiaries of such reductions are consumers when the prices they pay reflect excessive prices paid suppliers by the pipeline. To be sure, pipelines are entitled to charge their customers just and reasonable rates for gas sold them,[569] and a pipeline has a legitimate claim to retention of a rate reduction where it is absorbing excessive supplier-charges from revenues generated by just and reasonable rates of its own;[570] but no more than other natural gas entities subject to the Act can pipelines exact from their customer's rates which are either unjust or unreasonable.[571] Retention by a pipeline of supplier-rate reductions is tantamount to overcharging customers when the pipeline is already enjoying a fair margin of return.

The Commission possesses Section 7 authority to condition any certificate of public convenience and necessity which a pipeline seeks by an imposition of requirements designed to serve the public interest.[572] A requirement that a pipeline flow through reductions in its suppliers' rates, certainly where the pipeline does not claim that its own rates are too low, is an eminently reasonable condition in the public interest. Should either the pipeline or the Commission feel a need to reexamine the pipeline's rates, the remedies conferred by Section 4 and 5 are available.[573] In the meantime, the flow-through gives consumers the protection which the Section 7 certification process is designed to extend.[574]

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[569] See text *supra* at notes 365-66.
[570] See text *infra* at notes 575-78.
[571] See text *supra* at notes 365-68.
[572] See Part III(A), *supra*.
[573] See Part III(A), *supra*.
[574] See Part III(A), *supra*.

Entitlement to refunds of excessive rates charged pipelines by suppliers rests upon similar considerations. The only real difference in principle results from the difference in character of a rate reduction as remediation for the future and a rate refund as restitution for the past. A pipeline does not merit a supplier refund rectifying exorbitance in a supplier rate simply because it was the pipeline that directly paid the supplier that rate.[575] "The aim of the Act was to protect ultimate consumers of natural gas from excessive charges. . . . They were the intended beneficiaries of rate reductions ordered by the federal commission, though state machinery might have to be invoked to obtain lower rates at the consumer level."[576] If the pipeline's rates to its customers were pushed below a just and reasonable level by the pipeline's absorption of the supplier's excessive rates, the pipeline's claim, of course, commands respect.[577] But when, on the other hand, the supplier's overcharge has already been recouped by the pipeline through higher charges to customers, there is no foundation upon which such a claim can validly be asserted. In sum, the re-

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[575] *FPC* v. *Interstate Natural Gas Co., supra* note 550, 336 U.S. at 581.

[576] *Id.* (citation omitted). See also note 552, *supra*.

[577] "The rates charged a wholesaler are part of its costs, reflected in its rate base. Reduction of those costs normally will lead in due course to reduction in its resale rates, unless we are to assume that the passage of the Natural Gas Act was an exercise in futility. It is of course conceivable that a wholesaler might be warranted in keeping all or a part of the rate reduction under the standards of reasonableness prescribed by the Act. But a court would not be warranted in assuming that the rates which have been charged are so low as to be unreasonable. No such presumption attends rates which have been fixed pursuant to rate orders of the commission. Nor can we make any such presumption as respects rates fixed by the utilities themselves without the compulsion of a rate order. For experience does not indicate that utilities are wont to charge themselves out of business." *Id.* at 581-82.

sponsibility to dispose of a refund "plainly cannot be discharged by payment of the fund to those who show no loss."[578]

F. *Flow-Through of Rate Reductions*

The presiding examiner concluded that in consequence of the reduction, through conventionalization of the lease-sale, of the rate which producers could obtain from Texas Eastern, the commodity charge in the latter's systemwide rates should be lowered.[579] In Opinion No. 565, the Commission did not reach Texas Eastern's contention that Section 7 did not authorize that course because it felt that another treatment would in any event be appropriate.[580] Since Texas Eastern had pending before the Commission a Section 4 proceeding for a rate increase, sought partly on the basis of its Rayne Field costs, the Commission settled on a reduction of Texas Eastern's rates as an interim step for the Section 4 proceeding.[581] Accordingly, the Commission ordered Texas Eastern to file substitute rates reflecting cost shrinkage arising from the instant proceeding, and to continue in effect rates reflecting costs at the applicable area rate until full payment to producers of the $134 million purchase price and amortization of the balance of the Rayne Field investment on its books, and thereafter to file new rates.[582]

The Commission's general authority to issue interim rate orders is beyond question.[583] And indubitably, an

[578] *Id.* at 582.

[579] See text *supra* at note 500.

[580] See text *supra* at notes 501-02.

[581] See text *supra* at notes 503-05.

[582] See text *supra* at notes 506-08.

[583] *FPC* v. *Tennessee Gas Transmission Co., supra* note 464, 371 U.S. at 150; *FPC* v. *Natural Gas Pipeline Co.,* 315 U.S. 575, 583-85 (1942).

interim order may decrease existing rates which are excessive.[584] The Commission might have entered an interim rate-reduction order in Texas Eastern's pending Section 4 proceeding on a finding that its rates were too high.[585] We see no infirmity in the action here arising simply from the fact that the Commission chose to promulgate such an order, on such a finding, in the Section 7 proceeding as a step promoting the public interest in the Section 4 proceeding.[586] We accordingly accept the Commission's rate-reduction order for what it purports to be.

We hasten to add, however, that the Commission might also have passed the order as an exertion of its Section 7 authority.[587] Texas Eastern's sole challenge before the Commission to the examiner's method of rate-reduction flow-through was that the Commission lacked power in a Section 7 proceeding to revise systemwide rates previously found to be just and reasonable.[588] The Commission met that objection by issuance, for Texas Eastern's rate-increase proceeding, of the order on an interim basis upon a finding essentially that without flow-through of the reductions Texas Eastern's charges to customers would not remain reasonable. The Commission was equally free to flow through the reductions by an exercise of its Section 7 powers without encountering the criticism Texas Eastern offered. The methodology of Section 7

[584] *FPC* v. *Tennessee Gas Transmission Co., supra* note 464, 371 U.S. at 151; *FPC* v. *Natural Gas Pipeline Co., supra* note 583, 315 U.S. 583-85.

[585] *FPC* v. *Tennessee Gas Transmission Co., supra* note 464, 371 U.S. at 150-55.

[586] While the order in question looks rather far into the future, we accept it as the interim measure the Commission says it is—to be continued or superseded according to the outcome of the Section 4 proceeding.

[587] See Part VI(E), *supra.*

[588] *Texas Eastern Transmission Corp.* (Order No. 565), *supra* note 16, 42 F.P.C. at 400.

flow-through is an imposition of certificate conditions pending any formal rate investigation that might be in order.[589] The very purpose of Section 7 certificate conditions is protection of consumers while the normally lengthy rate investigation is proceeding.[590] The mechanism of Section 7 condition-imposition is not ratemaking; indeed, ratemaking incidental to a levy of such conditions is unnecessary and inappropriate.[591] Texas Eastern's point fails both as to the avenue the Commission took and the one it could have taken.

The woes of rate-reduction flow-through do not end at this point, however, for the disposition ordained in Opinion No. 565 was soon cast aside. In Opinion No. 565-A, the Commission substituted the 20-cent in-line price for the 18.5-cent area rate as the basis for a producer rate-schedule filing to reflect what the Commission then deemed the appropriate producer reduction.[592] The Commission also concluded that "it would not be in the public interest to require" a new rate filing by Texas Eastern to track the 20-cent producer rate for the stated reason that such a filing "might result in only a temporary reduction to its customers, and thus would bring about only a condition of instability without commensurate benefits."[593] Instead, the Commission levied on Texas Eastern a contingent liablity to make refunds in the future to the extent that its actual rates exceed rates reflecting a 20-cent producer rate.[594]

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589 See Part III(A), *supra.*

590 See Part III(A), *supra.*

591 *FPC v. Interstate Natural Gas Co., supra* note 550, 336 U.S. at 583, 584.

592 See Part VI(C), *supra.*

593 See note 542, *supra.*

594 See note 542, *supra.*

We have seen that the objective of initial gas-pricing in Section 7 certification proceedings must constantly be protection of consumers against exorbitance during the period prior to establishment of firm prices by the rate-making process.[595] We have held that the initial price which Texas Eastern should have been directed to pay its Rayne Field producers was the 18.5-cent just and reasonable rate then prevailing.[596] The exemption of Texas Eastern from a reduction of customer rates and the displacement of the 18.5-cent rate by the 20-cent rate are totally at war with these vital considerations. Leaving Texas Eastern's too-high rates operative obviously sacrifices the interest of its customers in "the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest," which was, we have said, their due.[597] No more with respect to Texas Eastern than to the producers was the Commission's apprehension of "a condition of instability" sufficient justification for diluting that interest.[598] Nor is a refund liability an adequate substitute for the rate reduction which the Commission spurned.[599]

In this posture of the case, it is clear that as a matter of law Opinion No. 465-A is erroneous and Opinion No. 565 is right in its treatment of rate-reduction by Texas Eastern. We must, then, set Opinion No. 565-A aside on that score. By the same token, since the Commission had no perceivable legal alternative to the disposition it assigned that matter in Opinion No. 565, we sustain the Commission's position in that respect.

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595 See Parts III(A), V(B), *supra.*
596 See Part V(B)(1), *supra.*
597 See text *supra* at notes 372-73.
598 See discussion in Parts V(B)(1), (2).
599 See *FPC v. Tennessee Gas Transmission Co., supra* note 464, 371 U.S. at 154-55.

G. *Flow-Through of Rate Refunds*

For some time the Commission appears to have allocated supplier refunds between pipelines and their customers by application of a simple principle. Entitlement depended upon whether the pipeline had increased its rates to accommodate the increase in the supplier rates. If it had, customers got the refund; if it had not, the pipeline was preferred.[600] That rule, so far as it goes, plainly harmonizes with the aims and philosophy of the Act,[601] and we encounter no difficulty in sustaining it as a major thesis in the allocative process.

In 1968, in its Opinions Nos. 540 and 540-A, as we have explained, the Commission superimposed upon that principal the requirement that a pipeline contending for a refund resulting from a supplier-rate increase later disallowed must have filed a tracking rate increase of its own.[602] The justification for this requirement is that the effect of absorption of the supplier increase on the pipeline's earnings position, and consequently on the relative equities of the pipeline and its customers in respect to the refund, can be suitably ascertained only when subjected to close scrutiny.[603] The Commission held that Texas Eastern, the pipeline there involved, could not retain a supplier refund where it had not filed a tracking rate increase and did not show that it had earned less than a reasonable margin of return during the period in question.[604]

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[600] See the discussion in *Texas Eastern Transmission Corp.* v. *FPC, supra* note 509, 414 F.2d at 346-47.

[601] See Part VI(E), *supra.*

[602] See Part V(B), *supra.*

[603] *Texas Eastern Transmission Corp.* (Opinion No. 540), *supra* note 509, 39 F.P.C. at 638-41.

[604] The new requirement of a tracking rate increase filing was adopted prospectively, and the Commission gave Texas Eastern an opportunity to establish factually its entitlement to the refund. *Id.* at 641-43.

On review of that ruling in the Fifth Circuit, the Commission was sustained.[605] The court rejected Texas Eastern's primary argument that it was entitled to the refund as restitution for the sum it paid, as an increased cost, to its suppliers without passing that cost on to its customers:

> Our view is that the Commission was authorized to see to disposition of the refunds in question on the basis of the purpose of the Act to protect ultimate consumers of natural gas. It must be borne in mind that the Commission created the refunds by disallowing supplier rate increases and by requiring that the sums in question be retained by the suppliers pending determination of entitlement. Texas Eastern could have filed rate increases to track the supplier increases. It chose not to do so for reasons of its own. One reason, no doubt, was that the Commission could have investigated the rates in the light of Texas Eastern's earnings.
>
> Here the Commission afforded Texas Eastern the opportunity of justifying its entitlement to the refunds on a earnings basis without the concomitant risk of an investigation of its rates as would have been the case in the event of rate filings. This procedure was adopted to protect Texas Eastern in the face of the change in Commission policy as to disposition of refunds. This was a fair approach from the standpoint of protecting the interest of Texas Eastern and the consumer. To adopt Texas Eastern's position that it is, *ipso facto,* entitled to the refunds by virtue of having paid and absorbed them would be to countenance rate making by the producer-suppliers and Texas Eastern outside the protective ambit of § 4(e). This approach would do violence to the statutory scheme by avoiding, to the extent the refunds exceed a fair return to Texas Eastern, any rate regulation whatever except under § 5 of the Act.[606]

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[605] *Texas Eastern Transmission Corp.* v. *FPC, supra* note 509.

[606] 414 F.2d at 348.

We agree with the Fifth Circuit that the requirement of a tracking rate increase is amply supported by the goals sought by the Act. In Opinion No. 565, however, the Commission held that the fact that Texas Eastern did not file such an increase did not totally bar it from sharing in the refunds ordered by the producers. Disagreeing with the examiner, the Commission distinguished Opinions Nos. 540 and 540-A on grounds hardly characterizable as irrational. Instead of a supplier-rate increase which might have been tracked by a pipeline increase filing, there was a lease-sale transaction involving a large capital investment which was not itself susceptible of tracking.[607] The conventionalization of the lease-sale upon which the Commission decided was partial only — for purposes related to payment for Rayne Field gas, but not for all others.[608] With the Rayne Field investment remaining a capital item because unconventionalized, Texas Eastern could have tracked only the expense by-products of the investment — depreciation, depletion and amortization — together with Rayne Field expenses and taxes which were not capitalized.[609] Beyond that, the evidence, by the Commission's appraisal, established that Texas Eastern had passed on to its customers less than $14 million of some $76 million in Rayne Field expenditures — the excess of the actual per-Mcf cost of the gas under the lease-sale formula over a 20-cent in-line unit price.[610]

On this analysis, the Commission in Opinion No. 565, required Texas Eastern to flow through nearly $14 million of the producers' refund, together with an aliquot

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[607] See text *supra* at note 520.

[608] See text *supra* at note 520.

[609] See text *supra* at notes 522-24.

[610] See text *supra* at notes 525-26.

portion of the interest thereon charged the producers,[611] and permitted Texas Eastern to apply the remainder of the refund in reduction of its investment.[612] This disposition of the refund issue encounters opposition from both pipeline and consumer viewpoints, and on divergent grounds. Texas Eastern, claiming the entire refund, asserts that capitalization of the bulk of its Rayne Field expenditures was not only a prudent decision[613] but also a sound accounting practice, particularly because of the resemblance of those expenditures to prepayments for gas in conventional purchases,[614] and that no part of the investment could have been passed on to customers through the medium of a tracking rate increase. PSC, on the other hand, claiming all of the refund for consumers, argues that as a matter of accounting capitalization of the expenditures was unauthorized by the Commission's regulations,[615] and that the Commission's computation of the amount of the customer overcharge was of dubious validity because no cost of service for the period in question was ever found.[616]

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[611] The amount to be flowed through, as to both principal and interest, was to be updated. See text *supra* at note 529.

[612] See text *supra* at notes 531-40.

[613] Opinion No. 565 so stated. See text *supra* at note 520.

[614] The examiner concluded that under the circumstances Texas Eastern could not be permitted to treat any of its Rayne Field expenditures as prepayments. *Texas Eastern Transmission Corp.*, *supra* note 43, 42 F.P.C. at 462-63 (examiner's Phase II decision). A majority of the Commission in Opinion No. 565 concluded similarly, *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 399, see note 539, *supra*, as did two commissioners in Opinion No. 565-A. *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1088. See *Public Serv. Comm'n* v. *FPC*, 151 U.S.App.D.C. 307, 467 F.2d 361 (1972).

[615] See note 539, *supra*.

[616] In finding the amount of Rayne Field costs which Texas Eastern had already imposed on its customers, the Commission examined the testimony of three expert witnesses, each of whom had made computations on the basis of the costs of the Rayne Field gas to Texas Eastern. The Commission accepted the testimony of

By our assessment, we cannot compel the Commission to accept any of these claims. The question is not how we ourselves would dispose of these arguments but whether the disposition the Commission chooses is arbitrary or otherwise inconsistent with law.[617] Factual findings by the Commission, when supported by substantial evidence on the record as a whole, are conclusive upon the courts.[618] And "[t]he judicial function is exhausted when there is found to be a rational basis for the conclusions approved by the administrative body."[619] We see nothing that would exempt this case from those rules.

Looking first to Texas Eastern's contentions, we start from the premise that a public utility's investors have a general right to recoup from consumers the full amount of the capital outlay they have devoted to the public service.[620] But investors have no right to a second recovery of so much of their investment as consumers have

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one of the three witnesses who made his calculations on the basis of the costs used to compute Texas Easterns successive rate settlements, see note 523, *supra*, an approach which the Commission deemed the most accurate reflection of Rayne Field costs. *Texas Eastern Transmission Corp.* (Opinion No. 565), *supra* note 16, 42 F.P.C. at 396-98.

617 *United States* v. *Pierce Auto Freight Lines*, 327 U.S. 515, 535-36 (1946); *Rochester Tel. Corp.* v. *United States*, *supra* note 189, 307 U.S. at 139-40; *ICC* v. *Union Pac. R.R.*, 222 U.S. 541, 547-48 (1912). See also *Mississippi Valley Barge Line Co.* v. *United States*, *supra* note 189, 292 U.S. at 286-87.

618 Natural Gas Act § 19(b), 15 U.S.C. § 717r(b) (1970).

619 *Rochester Tel. Corp.* v. *United States*, *supra* note 189, 307 U.S. at 146, quoting *Mississippi Valley Barge Line Co.* v. *United States*, *supra* note 189, 292 U.S. at 288-89; *Texas Eastern Transmission Corp.* v. *FPC*, *supra* note 509, 414 F.2d at 349-50.

620 *FPC* v. *Hope Natural Gas Co.*, *supra* note 229, 320 U.S. at 606-07; *FPC* v. *Natural Gas Pipe Line Co.*, *supra* note 583, 315 U.S. at 593; *Lindheimer* v. *Illinois Bell Tel. Co.*, 292 U.S. 151, 168-69 (1934).

already repaid.[621] Here the Commission, in Opinion No. 565, found that Texas Eastern's customers had been charged nearly $14 million of its net investment balance of some $20 million through rates that were higher than they should have been.[622] The Commission also found that some of Texas Eastern's expenditures were expense items[623] — and not prepayments treatable as capital items[624] — for which a tracking rate increase might have been sought,[625] and allowed if the sought-after increase survived the test of reasonableness.[626]

Our examination of the administrative record convinces us that these facts, upon which the Commission mainly rested the refund flow-through framed in Opinion No. 565, are well supported. Our appraisal of the conclusions which the Commission drew from those facts is that they are neither arbitrary nor unreasonable. We therefore are not at liberty to direct action which is at variance with the Commission's decision in Opinion No. 565 to require Texas Eastern to flow through to its customers a portion of the refund equal to the amount of Texas Eastern's investment recovery in the form of customer charges which were higher than they otherwise would have been. We recognize, of course, that the refunding aspects of Opinion No. 565 may have lost their vitality by reason of supersession by the suspension provisions of Opinion No. 565-A, notwithstanding the in

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621 *E.g.*, *Williams* v. *Washington Metropolitan Area Transit Comm'n*, *supra* note 431, 134 U.S.App.D.C. at 374-76, 415 F.2d at 954-56; *Washington Gas Light Co.* v. *Baker*, 88 U.S. App.D.C. 115, 125, 188 F.2d 11, 21 (1950), *cert. denied*, 340 U.S. 952 (1951).

622 See text *supra* at note 526.

623 See text *supra* at notes 520-23.

624 See notes 539, 614, *supra*.

625 See text *supra* at notes 520-23.

626 See *Texas Eastern Transmission Corp.* v. *FPC*, *supra* note 509, 414 F.2d at 348.

validity of the latter.[627] But the fact remains that as a court we cannot assume the Commission's prerogatives by ordering a course of action it is not legally obliged to take.[628]

For similar reasons, and contrary to PSC's position, we cannot disregard the Commission's determination in Opinion No. 565 that the residue of the refund should be applied to reduce the net balance of Texas Eastern's investment in Rayne Field. Given the breadth of administrative authority to set practices which are matters purely of desirable accounting,[629] we perceive no basis for disturbing the Commission's conclusion that some $20 million of Texas Eastern's unrecovered Rayne Field expenditures have been properly capitalized. And given the expert testimony underlying the Commission's finding that a substantial portion of those expenditures had not been passed on to Texas Eastern's customers,[630] we are unable to say that ascertainment of Texas Eastern's cost of service was prerequisite to allocation to it of an equitable share of the refund.[631] As Commissioner O'Connor was later to observe, "[t]o flow through the entire amount of the refund would preclude Texas Eastern from

[627] See Part VI(D), *supra*.

[628] *Ohio Fuel Gas Co.* v. *FPC*, *supra* note 7, 111 U.S.App.D.C. at 338, 296 F.2d at 595; *Michigan Gas & Electric Co.* v. *FPC*, 110 U.S.App.D.C. 183, 185, 290 F.2d 374, 376, *cert. denied*, 368 U.S. 897 (1961); *Battle Creek Gas Co.* v. *FPC*, 108 U.S.App.D.C. 209, 213, 281 F.2d 42, 46 (1960).

[629] See *FPC* v *East Ohio Gas Co.*, 338 U.S. 464, 474-76 (1950); *United States* v. *New York Tel. Co.*, 326 U.S. 638, 654-55 (1946); *Northwestern Elec. Co.* v. *FPC*, 321 U.S. 119, 123-24 (1944); *American Tel. & Tel. Co.* v. *United States*, 299 U.S. 332, 336-67 (1936).

[630] See note 616, *supra*.

[631] See Part III(A), *supra*.

recovering its costs,"[632] and "[t]he effect would be that consumers for the past ten years would receive gas at a price below its cost to the pipeline and below the just and reasonable rate."[633] "This," he declared, "to me is unconscionable,"[634] and it may well be to other commissioners too.

Were the only issue emerging the legal vulnerability of Opinion No. 565, we would affirm its treatment of refund flow-through. The litigation, however, is further complicated by the course the Commission subsequently took in Opinion No. 565-A. Producer refunds were deferred pending reconsideration of the area rate for Southern Louisiana, leaving nothing to flow through to Texas Eastern's customers.[635] The legal effect of that action is our final inquiry.

As we have previously ruled, the Commission erred in postponing refunds by the producers to Texas Eastern.[636] We need not duplicate our earlier analysis and discussion of relevant legislative policy, or of the substantial body of judicial precedent, demanding speedy refunding by natural gas companies for the protection of consumers. It suffices to point simply to the Supreme Court's admonition, specifically referable to customer refunding, that the Commission had the duty, "where refunds are found due, to direct their payment at the earliest possible moment consistent with due process.[637] The postponement of producer refunds and, in consequence, of refund flow-

[632] *Texas Eastern Transmission Corp.* (Opinion No. 565-A), *supra* note 68, 44 F.P.C. at 1093 (separate opinion).

[633] *Id.*

[634] *Id.*

[635] See Part VI(C), *supra*.

[636] See Parts III(A), V(C), (D), *supra*.

[637] *FPC* v. *Tennessee Gas Transmission Co.*, *supra* note 464, 371 U.S. at 155.

through by Opinion No. 565-A was plainly a default in that responsibility, and it follows that that facet of Opinion No. 565-A must be disapproved. In the case at bar, there must be producer refunds;[638] and with no apparent justification for total retention by Texas Eastern, its customers must share in them.

But notwithstanding that, and though we leave untouched the flow-through principles which the Commission applied in Opinion No. 565, we must reject the amounts which that opinion would have respectively allotted to Texas Eastern and its customers from the producer refund. The Commission, for part of the relevant period, calculated the refund on the basis of the in-line unit price of the gas delivered to Texas Eastern.[639] Since we have held that the proper basis for computation was the just and reasonable rate throughout that period,[640] the refund will be larger than the Commission believed it to be.[641] We must, then, remand the case to the Commission in order that the amount of the producers' refund and the portions thereof to be retained and to be flowed through by Texas Eastern, may be recalculated.

VII. The Second Southern Louisiana Area Rate Proceeding

After this litigation made its appearance in this court, the Commission announced Opinion No. 598 and an ef-

[638] See Parts V(D) (1), (2), *supra*.

[639] See Part V(D) (2), *supra*.

[640] See Part V(D) (2), *supra*.

[641] The increase in the amount of the refund will result from the difference between the 20-cent in-line price, which the Commission used, and an 18.5-cent just and reasonable rate as the measure of the amount properly payable by Texas Eastern to the producers for the gas delivered.

fectuating order, by which the maximum rates chargeable for gas produced in the Southern Louisiana area were revised upward.[642] That decision does not, however, alter the conclusions we have expressed as to the basis for computation of producer refunds due Texas Eastern,[643] and of flow-through of those refunds by Texas Eastern,[644] prior to August 1, 1971, the effective date of the increases permitted by Opinion No. 598.[645] In that view, this latest promulgation of area rates for Southern Louisiana does not affect our ruling respecting the treatment of those matters in the Commission's pre-1971 Opinions Nos. 565 and 565-A.

Of course, by the terms of Opinon No. 565, the maximum price which Texas Eastern could pay the producers for gas extracted from Rayne Field rose to the applicable new area rate on the date it took effect.[646] That rise, in turn, had obvious implications, from that time onward, for the rates which Texas Eastern could charge its customers,[647] for refunds by the producers to Texas Eastern,[648] and for flow-through of such refunds by Texas Eastern,[649] matters as to which we are not now summoned to express any opinion. We think, however, as we have held,[650] that producer refunds and pipeline flow-through up to the operative date of the new area rates must be calculated on the basis of the original

[642] *Southern Louisiana Area Rate Proceeding* (Opinion No. 598), 46 F.P.C. 86 (1971), *aff'd sub nom. Placid Oil Co. v. FPC*, 483 F.2d 880 (5th Cir. 1973).

[643] See Parts V(C), (D) (1), (2), *supra*.

[644] See Parts VI(E), (G), *supra*.

[645] *Southern Louisiana Area Rate Proceeding* (Opinion No. 598), *supra* note 642, 46 F.P.C. at 142.

[646] See text *supra* at note 56.

[647] See Part VI(E), *supra*.

[648] See Parts V(C), (D) (2), *supra*.

[649] See Part VI(G), *supra*.

[650] See Parts V(A), (B) (2), VI(E), (G), *supra*.

18.5-cent just and reasonable area rate established in the Commission's first *Southern Louisiana Area Rate Proceeding*.[651]

During the pendency of the proceeding leading to Opinion No. 598, a settlement conference was convened by the Commission, and eventually a settlement proposal was submitted by 32 major producing companies.[652] The proposal envisioned higher ceiling prices for gas whether sold under contracts dated before or after October 1, 1968,[653] and a total of $150 million in refunds — a reduction from $375 million — from sales subject to scrutiny in specified Commission dockets.[654] The Commission approved the proposal,[655] and adopted for the Southern Louisiana area the price ceilings and refunds bases which it advanced.[656]

Very importantly, however, neither the settlement proposal nor Opinion No. 598 or its related order embraced the refund questions presented in the case at bar. The settlement proposal explicitly admonished that "[t]he terms hereof do not dispose of any issues in the *Rayne Field* (Docket No. G-12446, *et al.*) . . . proceedings"[657] — the litigation now before us — and its refund provisions were expressly made subject to that exclusion.[658] In turn, the Commission, in its words in Opinion No. 598, "adopt[ed] those provisions of the settlement proposal which prescribe[d] the . . . refund provisions for de-

[651] *Supra* note 53.

[652] *Southern Louisiana Area Rate Proceeding* (Opinion No. 598), *supra* note 642. 46 F.P.C. at 103-10, 153-64.

[653] *Id.* at 155-60.

[654] *Id.* at 160-63.

[655] *Id.* at 103-10.

[656] *Id.*, *passim.*

[657] *Id.* at 155.

[658] *Id.* at 160.

liveries made."[659] And just as the settlement proposal defined the transactions subject to refund in terms excluding the gas sales involved here, so did the order accompanying Opinion No. 598.[660]

We need not, in these circumstances, consider whether Opinion No. 598 could in any event affect the refund and flow-through issues which the Commission was called on to resolve several years previous to its promulgation. The critical fact is that Opinion No. 598 left those issues untouched. For that reason, we have concluded that our disposition of the refund and flow-through questions presented on this review must remain uninfluenced by Opinion No. 598.

VIII. Summary and Disposition

The Commission's action in the controversy we have reviewed is incorporated in Opinion No. 565 as changed by Opinion No. 565-A, in Opinion No. 565-A, and in the orders emanating from those opinions.[661] We sustain (a) the Commission's decision, in both opinions, to conventionalize some features of the lease-sale arrangement in the public interest;[662] and (b) the Commission's authority, exercised in the two opinions, to displace the lump-sum lease-sale contract price with an initial unit price for the gas sold Texas Eastern by the producers, and to appropriately implement that unification.[663] We accordingly affirm these aspects of Opinions Nos. 565 and 565-A and their accompanying orders.

[659] *Id.* at 140.

[660] *Id.* at 145. The order specifies the proceedings, by docket references, in which the refunds provided were due, and the proceedings we now review were not included.

[661] See Part II(C), *supra.*

[662] See Part III(C), *supra.*

[663] See Part IV(C) (1), *supra.*

We hold, however, that the Commission erred (a) in eliminating, by Opinion No. 565-A, the lease-sale contract price as the ceiling for the aggregate of Texas Eastern's payments to the producers;[664] (b) in adopting, at least to some extent by both opinions, the 20-cent in-line price as the initial unit price for gas delivered prior to August 1, 1971;[665] and (c) in deferring, by Opinion No. 565-A, rate reductions[666] and refunds[667] by producers to Texas Eastern, and flow-through of the reductions[668] and refunds[669] by Texas Eastern after taking into consideration its investment in Rayne Field.[670] We reverse Opinion No. 565 and its companion order in these respects.

Our rulings necessitate a remand of the cases under review to the Commission. We instruct the Commission, on remand, (a) to increase, beyond the lease-sale contract price, the aggregate amount which Texas Eastern is to pay the producers by a sum equal to the time value of the monies otherwise to be paid;[671] (b) to compute, utilizing the then existing 18.5-cent just and reasonable area rate as the basis, refunds by the producers to Texas Eastern on account of gas deliveries prior to August 1, 1971;[672] (c) to compute, after due regard for Texas Eastern's Rayne Field investment,[673] the amount to be flowed through by Texas Eastern, on account of producer refunds prior to August 1, 1971, on the basis of the 18.5-cent just and reasonable area rate in operation during

[664] See Part IV(C) (2), *supra.*
[665] See Parts V(B) (1), (2), VII, *supra.*
[666] See Part V(B) (2), *supra.*
[667] See Part V(D) (1), *supra.*
[668] See Part VI(F), *supra.*
[669] See Part VI(G), *supra.*
[670] See Part VI(G), *supra.*
[671] See Parts IV(B), (C) (2), *supra.*
[672] See Parts V(C), (D) (2), VII, *supra.*
[673] See Part VI(G), *supra.*

the period;[674] (d) to suitably update all rate-reduction, refund and flow-through computations;[675] and (e) to order all proper rate reductions and refunds to be made and flowed through at the earliest practicable times.[676] It goes without saying that the Commission will conduct all further proceedings consistently with the holdings and principles articulated in this opinion.

So ordered.

[674] See Parts VI(G), VII, *supra.*

[675] See Part VII, *supra.*

[676] See Parts V(B) (2), (D) (1), VI(F), (G), *supra.* We have also indicated our approval of rate-reduction flow-through, as decided by the Commission in Opinion No. 565. See Part VI(F), *supra.* New area rates for Southern Louisiana, however, are now in effect, see Part VII, *supra,* which by force of Opinion No. 565 govern the prices Texas Eastern must pay the producers. See Parts V(A), (B) (1), *supra.* The Commission will, of course, be guided on remand by the views we have expressed in that connection.

APPENDIX B

ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT AMENDING OPINION OF MARCH 25, 1975, FILED AUGUST 27, 1975

UNITED STATES COURT OF APPEALS

For The District Of Columbia Circuit
September Term, 1974

No. 24,716

Public Service Commission Of The State Of New York,
Petitioner

v.

Federal Power Commission,
Respondent

No. 24,823

Sun Oil Company,
Petitioner

v.

Federal Power Commission,
Respondent

No. 24,824

General Crude Oil Company,
Petitioner

v.

Federal Power Commission,
Respondent

No. 24,825

M. H. Marr,
Petitioner

v.

Federal Power Commission,
Respondent

UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

SEPTEMBER TERM, 1974

No. 24,836

CONTINENTAL OIL COMPANY,
Petitioner

v.

FEDERAL POWER COMMISSION,
Respondent

No. 24,846

TEXAS EASTERN TRANSMISSION CORPORATION,
Petitioner

v.

FEDERAL POWER COMMISSION,
Respondent

Before: Fahy, Senior Circuit Judge; Tamm and Robinson, Circuit Judges

ORDER

It is ORDERED by the Court, sua sponte, that the opinion of the Court filed March 25, 1974, in the above entitled case be and hereby is amended by deleting the first two lines at the top of page 87 and substituting therefore the language "fixed just and reasonable price ceilings including 18.5 cents for onshore natural gas of the Rayne Field".

Per Curiam

For the Court:

HUGH E. KLINE, *Clerk*

By: ROBERT A. BONNER
Robert A. Bonner
Chief Deputy Clerk

APPENDIX C

SUPPLEMENTAL OPINION ON PETITIONS FOR REHEARING OF THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT DECIDED AUGUST 27, 1975

UNITED STATES COURT OF APPEALS

For The District Of Columbia Circuit

No. 24,716

Public Service Commission of the State of New York,
Petitioner

v.

Federal Power Commission, *Respondent*

Texas Eastern Transmission Corporation,
Sun Oil Company, General Crude Oil Company,
Continental Oil Company, and M. H. Marr, *Intervenors*

No. 24,823

Sun Oil Company, *Petitioner*

v.

Federal Power Commission, *Respondent*

Texas Eastern Transmission Corporation and
Philadelphia Gas Works Division of UGI Corporation,
Intervenors

No. 24,824

General Crude Oil Company, *Petitioner*

v.

Federal Power Commission, *Respondent*
Texas Eastern Transmission Corporation and
Philadelphia Gas Works Division of UGI Corporation,
Intervenors

No. 24,825

M. H. MARR, *Petitioner*

v.

FEDERAL POWER COMMISSION, *Respondent*

TEXAS EASTERN TRANSMISSION CORPORATION AND PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION, *Intervenors*

No. 24,836

CONTINENTAL OIL COMPANY, *Petitioner*

v.

FEDERAL POWER COMMISSION, *Respondent*

TEXAS EASTERN TRANSMISSION CORPORATION AND PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION, *Intervenors*

No. 24,846

TEXAS EASTERN TRANSMISSION CORPORATION, *Petitioner*

v.

FEDERAL POWER COMMISSION, *Respondent*

SUN OIL COMPANY, CONTINENTAL OIL COMPANY, M. H. MARR, GENERAL CRUDE OIL COMPANY, AND PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION, *Intervenors*

SUPPLEMENTAL OPINION ON PETITIONS FOR REHEARING

Decided August 27, 1975

Before FAHY, *Senior Circuit Judge,* and TAMM and ROBINSON, *Circuit Judges.*

Opinion for the Court filed by *Circuit Judge* ROBINSON.

SPOTTSWOOD W. ROBINSON, III, Circuit Judge, with whom TAMM, Circuit Judge, joins:

The Commission and the producers petition for rehearing and modification of our decision[1] in several of its more important aspects. In substantial degree, their contentions merely echo arguments which have already been dealt with, and which we find upon reconsideration to merit no further discussion. There is, however, a recurring challenge which might be thought to draw support from a decision of the Supreme Court[2] announced after rendition of our prior opinion, and to that we now give primary attention. There are, too, several points on which brief additional explanation is apt to promote clearer understanding of the scope and basis of particular holdings, and these we also address.[3] Doing so, and concluding that no change in our original determination is warranted, we deny the petitions.

I

In Mobil Oil Corporation v. Federal Power Commission,[4] the Supreme Court reviewed and sustained the order

[1] *Public Serv. Comm'n* v. *FPC,* No. 24,716 (D.C. Cir. Mar. 25, 1974), hereinafter cited "Op.".

[2] *Mobil Oil Corp.* v. *FPC,* 417 U.S. 283, 94 S.Ct. 2328, 41 L.Ed.2d 72 (1974).

[3] See notes 42, 43, 46, 108, *infra.*

[4] *Supra* note 2.

effectuating the Commission's Opinion No. 598,[5] the second of two major pronouncements in a proceeding to set area rates for natural gas produced in Southern Louisiana. *Mobil* followed by more than two months our earlier opinion in the case at bar. Since the events leading to *Mobil*, and the decision itself, introduce and define the principal matter we now speak to, we pause momentarily to summarize them.[6]

On September 25, 1968, a seven-year investigation by the Commission culminated in Opinion No. 546[7] which, *inter alia*, established 18.5 cents per Mcf as the just and reasonable area rate, effective October 1, 1968, for onshore natural gas of the Rayne Field vintage,[8] and directed refunds for gas sold subject to a refunding obligation during pendency of the investigation at prices exceeding the newly-fixed ceilings.[9] On appeal, the Fifth Circuit affirmed,[10] but authorized the Commission to reopen the

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[5] Southern Louisiana Area Rate Proceeding (Opinion No. 598), 46 F.P.C. 86 (1971), *on rehearing* (Opinion No. 598-A), 46 F.P.C. 633 (1971), *aff'd sub nom. Placid Oil Co.* v. *FPC*, 483 F.2d 880 (5th Cir. 1973), *aff'd sub nom. Mobil Oil Corp.* v. *FPC*, *supra* note 2.

[6] We have already, in our previous opinion, referred quite extensively to area ratemaking in Southern Louisiana. See Op. text at ns. 69-75 & pts. V(B)(2), VII. *See also Mobil Oil Corp.* v. *FPC*, *supra* note 2, 417 U.S. at 292-300, 94 S.Ct. at 2338-2341, 41 L.Ed.2d at 86-90; *Placid Oil Co.* v. *FPC*, *supra*, note 5, 483 F.2d at 885-892.

[7] Southern Louisiana Area Rate Proceeding (Opinion No. 546), 40 F.P.C. 530 (1968), *on rehearing* (Opinion No. 546-A), 41 F.P.C. 301 (1969), *aff'd sub nom. Austral Oil Co.* v. *FPC*, 428 F.2d 407 (5th Cir.), *on rehearing*, 444 F.2d 125, *cert. denied*, 400 U.S. 950, 91 S.Ct. 241, 27 L.Ed.2d 257 (1970).

[8] Southern Louisiana Area Rate Proceeding (Opinion No. 546), *supra* note 7, 40 F.P.C. at 544, 636, 648.

[9] *Id.* at 626-628, 652-654. By the end of 1970, the refunds ordered totaled some $375 million. *Mobil Oil Corp.* v. *FPC*, *supra* note 2, 417 U.S. at 293 & n.8, 94 S.Ct. at 2326 & n.8, 41 L.Ed.2d at 87 & n.8.

[10] Southern Louisiana Area Rate Cases (*Austral Oil Co.* v. *FPC*), *supra* note 7.

proceeding and to readjust, retroactively as well as prospectively, the rate and refund provisions of its order should the public interest so require.[11] The Commission formally reopened[12] and, by adoption of the terms of a settlement proposal found to be supported by substantial evidence, promulgated a new rate order.[13] That order, delineated in Opinion No. 598, set a maximum price of 22.375 cents per Mcf for "flowing gas" — gas delivered after August 1, 1971, the effective date of the new order, under contracts predating October 1, 1968[14] — and provided for escalation of the price contingent upon new dedications of gas to the interstate market.[15] The new order also specified a formula for refunds, aggregating about $150 million,[16] with a provision for workoff credits based on commitments of additional gas reserves to that market.[17] The Fifth Circuit,[18] and in turn the Supreme Court in *Mobil*,[19] affirmed the order.

During most of the period covered by area ratemaking in Southern Louisiana, the Commission continued its quest for initial pricing of the Rayne Field gas, in suit, which had been certificated in 1959 and flowing through Texas Eastern's pipeline system since then.[20] On August 6, 1969,

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[11] 428 F.2d at 421, 444 F.2d at 126-127. See Op. text at ns. 409-413 and n. 413.

[12] Southern Louisiana Area Rate Proceeding, 44 F.P.C. 1638 (1970) (order reopening and consolidating proceedings.)

[13] Southern Louisiana Area Rate Proceeding (Opinion No. 598), *supra* note 5.

[14] *Id.* at 105, 135-138, 142-143.

[15] *Id.* at 138-139, 143.

[16] *Id.* at 140 n.140.

[17] *Id.* at 149-141, 145-148.

[18] *Placid Oil Co.* v. *FPC*, *supra* note 5.

[19] *Mobil Oil Corp.* v. *FPC*, *supra* note 2.

[20] See Op. pt. I.

the Commission issued its Opinion No. 565[21] wherein it found that the public interest demanded conventionalization of some aspects of the parties' lease-sale agreement to more nearly conform the transaction to an orthodox gas-sale contract.[22] The Commission then fixed initial prices for the gas at 20 cents per Mcf — the in-line price — until October 1, 1968, the operative date of Opinion No. 546, and thereafter at the 18.5-cent just and reasonable area rate prescribed by Opinion No. 546,[23] and directed producer refunds and pipeline flow-through on that basis.[24] On rehearing, the Commission, in Opinion No. 565-A,[25] reaffirmed the need to conventionalize[26] but in other critical respects changed its course. It held that the criterion for producer refunding, from certification onward, was the applicable area rate,[27] but felt that because the probe for area rates had been reopened, initial pricing and refunding should be deferred pending its outcome.[28] On further rehearing, the Commission adhered to those conclusions.[29]

In that posture, the litigation arrived in this court. We affirmed the Commission's decision, reached in each of the opinions, to conventionalize the transaction.[30] We agreed that a just and reasonable area rate in existence,

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[21] Texas Eastern Transmission Corp. (Opinion No. 565), 42 F.P.C. 376 (1968). See Op. pt. I(D).

[22] Texas Eastern Transmission Corp. (Opinion No. 565), *supra* note 21, 42 F.P.C. at 382-393.

[23] *Id.* at 383-390, 403.

[24] *Id.* at 393-398, 404-405.

[25] Texas Eastern Transmission Corp. (Opinion No. 565-A), 44 F.P.C. 1079 (1970).

[26] *Id.* at 1081-1085, 1092.

[27] *Id.* at 1084. 1088, 1097-1107.

[28] *Id.* at 1087-1088, 1097-1107.

[29] Texas Eastern Transmission Corp., 44 F.P.C. 1471 (1970) (order denying rehearing).

[30] Op. pt. III.

rather than the in-line price in that instance, was the proper measure both of initial prices prospectively[31] and of refunds and refund flow-through occasioned by collections above that rate in the past,[32] and to that extent we sustained Opinion No. 565-A.

We differed with that opinion, however, as to the deferral of refunds which it undertook to make. We concluded that the postponement could not be justified by the Commission's desire to await finalization of just and reasonable rates for Southern Louisiana.[33] We also concluded that the 18.5-cent area rate established in Opinion No. 546, though subject to possible revision, was the legally required basis for the Commission's initial pricing activities — for charging in the future and, as well, for refunding on account of the past.[34] We remanded to the Commission with instructions to proceed accordingly.[35]

These petitions for rehearing followed. In its petition, the Commission requested alternatively that we withhold our ruling pending the Supreme Court's action in *Mobil*. That we have done, and since have given the petitions the most careful consideration in light of the *Mobil* decision. We perceive no reason justifying change in our original disposition, and accordingly we deny the petitions.

Lest, in traversing the maze of problems bred by this litigation, its main bearings have become obscured, we reiterate several important considerations to be borne in mind. The central questions are prices, refunds and refund flow-through, not as terminal determinations, but as ar-

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[31] Op. pts. V(A), (B).

[32] Op. pts. V(C), (D)(2), VI(B)-(E), (G).

[33] Op. pt. V(D)(1).

[34] Op. pts. V(B), (C), (D)(1).

[35] Op. text at ns. 143-144.

rangements, pending finalization of the financial rights and obligations of the parties.[36] The duration and intensity of the instant controversy notwithstanding, the case has not advanced beyond certification — under Section 7 of the Natural Gas Act[37] — of the sale of the gas in question for the interstate market, or beyond the occasion for financial relationships simply for that purpose.[38] There has been no specific inquiry into rates or refunds under Sections 4 or 5 of the Act,[39] nor yet any determination as to permissible departures, by way of contingent price escalation or refund workoff, from the base rate fixed in Opinion No. 598.[40] All that has been done, and can be done at this stage, is of an interim nature.

Our decision calls for prompt refunds by the producers and flow-through by the pipeline, subject not only to any unrealized offsets occasioned by the new area rate effective on and after August 1, 1971,[41] but also to any other adjustments which further proceedings in this matter may indicate. The maximum effect of our decision is a present refund benefit to consumers for deliveries prior to that date, which in any event will be returned to the producers, up to the $134 million contract ceiling,[42] through collections at just and reasonable rates for deliveries after that date.[43]

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[36] *See Atlantic Ref. Co.* v. *Public Serv. Comm'n,* 360 U.S. 378, 388-392, 79 S.Ct. 1246, 1253-1255, 3 L.Ed.2d 1312, 1319-1321 (1959); Op. pt. III(A).

[37] Act of June 21, 1938, ch. 556, 52 Stat. 824, § 7, as amended, 15 U.S.C. § 717f (1970).

[38] *See Atlantic Ref. Co.* v. *Public Serv. Comm'n, supra* note 36, 360 U.S. at 388-392, 79 S.Ct. at 1253-1255, 3 L.Ed.2d at 1319-1321.

[39] As amended, 15 U.S.C. §§ 717c, 717d (1970).

[40] *See* Southern Louisiana Area Rate Proceeding *supra* note 5, 46 F.P.C. at 138-139, 140-141, 142-148.

[41] *See* Op. text at ns.646-649.

[42] The Commission asserts that we erred in holding that the doctrine laid down in United Gas Pipeline Co. v. Mobile Gas Serv. Corp., 350 U.S. 332, 76 S.Ct. 373, 100 L.Ed. 373 (1956), and FPC v. Sierra Pac. Power Co., 350 U.S. 348, 76 S.Ct. 368, 100 L.Ed. 388 (1956), precluded abrogation of the contract limitation of $134 million as the total price which the pipeline was to pay to the producers. We adhere to our earlier discussion and decision of that matter. Op. text at pts. IV(B), (C)(2). The Commission also asserts that we ventured outside the judicial domain when we instructed the Commission to increase the pipeline's payments beyond the $134 million by an amount equal to the time value of the monies called for by the Commission-rearranged payment schedule. Op. text at ns.341-349. We believe that we do not usurp an administrative prerogative when we direct a step which the Commission is legally bound to take. That is the situation here.

A Commission majority has repeatedly and consistently held that the parties' lease-sale disserved the public interest, and at least twice has held that the transaction should accordingly be conventionalized. Op. text at ns.345-347 and references in ns.345-346. As we have explained, "limiting [the pipeline's] financial liability to the contract price and [through conventionalization] spreading its discharge over a longer period of time [ ] would cause the producers to receive less than the *quid pro quo* for which they had contracted . . . because the value to the producers of the money to be paid over the longer time span would be less than its value by the payment schedule embodied in the lease-sale arrangement," Op. text at n.340; and various members of the Commission have recognized that the producers are entitled to relief. Op. text at n.344 and references in n.344. As we have declared "[e]xcept as the exigencies of the public interest demanded, the Commission was no more at liberty to alter the lease-sale contract to the prejudice of the producers than to do so in their favor." Op. text following n.340. Obviously, such prejudice could be avoided only by awarding the producers the time value of the money due them under the contract, a need which even the pipeline seemingly had recognized, Op. at n.348, and which even now it does not dispute.

We realize that a court may not compel an administrative agency to pursue a particular course of action when another is open to it.

It may be that when all is said and done about Rayne Field gas, the return will be faster.

II

Irrespective of the status of the Southern Louisiana area rate investigation and of just and reasonable rates for that area when the Commission promulgated Order No. 565-A, by our lights it was clear error to delay the matter of producer refunds to the conclusion of the re-

opened rate proceeding. In Opinion No. 565, a Commission majority ordered refunds on a finding that the producers had been greatly overpaid for gas deliveries made through 1967.[44] The majority in Opinion No. 565-A did not dispute that finding, but postponed all refunds on the theory that they should be predicated on whatever just and reason-

FPC v. Idaho Power Co., 344 U.S. 17, 20, 73 S.Ct. 85, 86-87, 97 L.Ed. 15, 20 (1952). See also note 108, *infra*. We have held that the Commission could not solve the problem by extending the pipeline's payments over the life of the field, Op. pts. IV(B), (C) (2), and no one has suggested any other feasible alternative to the one we directed, nor have we been able to conceive of any. Nor can it be realistically argued that the Commission might, as an alternative, have refused to certificate the sale of the gas in question in any form. As far back as 1968, when the Commission first decided to conventionalize the parties' lease-sale, almost half of the estimated volume of recoverable gas in the field had flowed through the pipeline to interstate points, and the Commission made it plain that it was too late in the day to reverse the transaction. Texas Eastern Transmission Corp. (Opinion No. 565), *supra* note 21, 42 F.P.C. at 383. As we see it, the Commission's well-nigh irrevocable commitment to conventionalization left it no legally available choice than the increase we ordered.

[43] For this reason, we cannot agree with the producers that they face financial loss in consequence of our decision. They are assured of ultimate receipt of the $134 million price for which they contracted, together with compensation for the rearranged timing in payment. See Op. pts. IV(B), (C)(2). See also note 42, *supra*.

[44] Texas Eastern Transmission Corp. (Opinion No. 565), *supra* note 21, 42 F.P.C. at 390, 403-405. The presiding examiner had found that the producers collected through 1967 $21.8 million — with interest, $31.4 million — more than deliveries at the 20-cent in-line rate would have commanded. Texas Eastern Transmission Corp., 42 F.P.C. 455, 460-461 (1968) (examiner's Phase II decision). The Commission adopted that finding in Opinion No. 565. Texas Eastern Transmission Corp. (Opinion No. 565), *supra* note 21, 42 F.P.C. at 383-405. The basis of the Commission-directed refunds were the 20-cent in-line rate to October 1, 1968, and the 18.5-cent just and reasonable rate thereafter. *Id.* at 390, 403-405. Although we disagreed with the first element of that formula, Op. pts V(B)(1), (C), (D)(2), we found no fault with the Commission's conclusion that refunds were due. Op. pt. V(D).

able rate for Rayne Field gas eventuated from the reopened inquiry as to appropriate rates for the area.[45]

In our earlier opinion, we deemed that action a disregard of the Supreme Court's admonition that "it is the duty of the Commission, 'where refunds are found due, to direct their payment at the earliest possible moment consistent with due process.'"[46] We were unable to distinguish the refund deferral ordained by Opinion No. 565-A from the deferral which the Court had previously condemned in its *Callery* decision.[47] We pointed out that "[e]ven assuming the nonexistence of any just and reasonable rate which might function as the basis for imme-

[45] Texas Eastern Transmission Corp. (Opinion No. 565-A), *supra* note 25, 44 F.P.C. at 1081, 1087-1088.

[46] Op. text at n.464. The quotation is from United Gas Improvement Co. v. Callery Properties, 382 U.S. 223, 230, 86 S.Ct. 360, 364, 15 L.Ed.2d 284, 290 (1965), in turn quoting FPC v. Tennessee Gas Transmission Co., 371 U.S. 145, 155, 83 S.Ct. 211, 216-217, 9 L.Ed.2d 199, 206 (1962). Once again we reject the contention that the Commission had no duty, as distinguished from the prerogative, to order refunds in the case at bar. As we said earlier, "[t]he Commission was not merely at liberty to require immediate refunds but, where refunds are due, it also had 'the duty . . . to direct their payment at the earliest possible moment consistent with due process.' That duty charts the only course in keeping with the purpose of the Act 'to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges.'" Op. text at ns.467-468 (footnotes omitted), quoting in turn, FPC v. Tennessee Gas Transmission Co., *supra*, 371 U.S. at 154, 83 S.Ct. at 216, 9 L.Ed.2d at 205-206, and Atlantic Ref. Co. v. Public Serv. Comm'n, *supra* note 36, 360 U.S. at 388, 79 S.Ct. at 1253, 3 L.Ed.2d at 1319. *See also* FPC v. Sunray DX Oil Co., 391 U.S. 9, 37, 88 S.Ct. 1526, 1541, 20 L.Ed.2d 388, 406 (1968); United Gas Improvement Co. v. Callery Properties, *supra*, 382 U.S. at 230, 86 S.Ct. at 364, 15 L.Ed.2d at 290.

[47] Op. at ns.462-468. In United Gas Improvement Co. v. Callery Properties, *supra* note 46, the Supreme Court reversed a judicial holding, practically identical to the Commission's administrative holding here, that refunding of excessive charges following certification should await establishment of the just and reasonable rate. 382 U.S. at 230, 86 S.Ct. at 364, 15 L.Ed.2d at 290.

diate refunds by the producers, that office could readily have been performed by the in-line price which the Commission ascertained in this very proceeding."[48] As we read the Court's *Mobil* opinion,[49] it does not overrule *Callery*, or affect our application of *Callery* in this case.

The Commission and the producers still urge nonetheless the propriety of the postponement on the ground, advanced in Opinion No. 565-A, that it promoted equality of treatment *vis-a-vis* other producers in Southern Louisiana.[50] We rejected that argument in our previous opinion,[51] and for even stronger reasons we do so again. The deferral discountenanced in *Callery* presumably would in similar degree have served the cause of producer equality, but in neither case could deferrals have done so without completely sacrificing the interest of consumers in prompt refunds for excessive initial prices.[52] In each case that interest complements the consumers' statutory entitlement to "the lowest possible rate consistent with maintenance of adequate service in the public interest,"[53] a matter with

[48] Op. text at n.460. That was the course approved in *Callery*, 382 U.S. at 226-228, 86 S.Ct. at 362-364, 15 L.Ed.2d at 287-289. *See also* FPC v. Sunray DX Oil Co., *supra* note 46, 391 U.S. at 37-38, 40-47, 88 S.Ct. at 1540-1541, 1542-1546, 20 L.Ed.2d at 405-406, 407-412. We also concluded that the applicable area rate established by Opinion No. 546 would more properly than the in-line rate have performed that function, Op. pts. V(B)(1), (2), (C), (D)(2), a point we discuss further in Part III hereof.

[49] *Supra* note 2.

[50] *See* Texas Eastern Transmission Co. (Opinion No. 565-A), *supra* note 25, 44 F.P.C. at 1087-1088. The only other ground averred in Opinion No. 565-A was that the 18.5-cent just and reasonable area rate for gas of Rayne Field vintage had not been finally determined. *Id.* We address that ground in Part III, *infra*.

[51] Op. text at ns.476-484.

[52] See Op. text at ns.481-482. *See also* FPC v. Tennessee Gas Transmission Co., *supra* note 46, 371 U.S. at 154-155, 83 S.Ct. at 216-217, 9 L.Ed.2d at 205-206.

[53] See text *infra* at note 69.

which Section 7 historically has maintained a vital concern.[54] Moreover, the Supreme Court's *Mobil* decision confirms our earlier suspicion[55] that equality in refunding among Southern Louisiana producers might be an illusory goal.[56] No more now than when we originally decided this case can we condone the refund deferral which the Commission indulged.

III

Beyond the delay in refunding commanded by Opinion No. 565-A is the problem of the rate therein selected as the basis for refunds. All are agreed that the applicable area rate ultimately upheld in *Mobil* controls the parties' financial relationships after August 1, 1971, the date the rate became operative. For Opinion No. 565 and its accompanying order specified that pipeline-producer payments would rise prospectively to the area rate, and to levels fixed by subsequent revisions thereof,[57] and the theory underlying the majority's disposition in Opinion No. 565-A was to the same effect.[58] By the same token, all pipeline charges, producer refunds and flow-through of those refunds became

[54] *See* Atlantic Ref. Co. v. Public Serv. Comm'n, *supra* note 36, 360 U.S. at 388-389, 79 S.Ct. at 1253-1254, 3 L.Ed.2d at 1319-1320. Op. text at ns.369-373.

[55] As we pointed out in our prior opinion, the extent to which the deferral of refunds could promote producer equality "might depend in part upon whether initial prices allowed producers were all fixed at the same level, since those prices established refund floors." Op. at n.481. *See* FPC v. Sunray DX Oil Co., *supra* note 46, 391 U.S. at 21-23, 24, 88 S.Ct. at 1532-1534, 20 L.Ed.2d at 396-399.

[56] The Court found that the refund formula eventually adopted for the Southern Louisiana area impacted producers unequally, but that the differences were justified by other regulatory concerns. 417 U.S. at 321-327, 94 S.Ct. at 2352-2354, 41 L.Ed.2d at 102-105.

[57] Texas Eastern Transmission Corp. (Opinion No. 565), *supra* note 21, 42 F.P.C. at 390, 403.

[58] *See* Texas Eastern Transmission Corp. (Opinion No. 565-A), *supra* note 25, 44 F.P.C. at 1084, 1088.

similarly affected from that point onward.[59] The issue was and is the rate appropriate for computation of producer refunds and pipeline flow-through on account of gas deliveries prior to the effective date of the 1971 rate order.

We concluded in our original opinion that neither Opinion No. 598 nor its related order itself undertook to extend the Commission's retroactive refund formula[60] toward resolution of that question.[61] We pointed out that the settlement agreement underlying Opinion No. 598 stated unequivocally that its provisions would not dispose of any issue confronting us in this litigation;[62] that the refund provisions of the settlement agreement were expressly made subject to that exclusion;[63] that Opinion No. 598 expressly adopted the refund provisions of the settlement agreement as written;[64] and that the order accompanying Opinion No. 598 defined the transactions subject to refund in terms excluding the gas deliveries involved here.[65] We said that "[w]e need not, in these circumstances, consider whether Opinion No. 598 could in any event affect the refund and flow-through issues which [in the instant case] the Commission was called on to resolve several years previous to its promulgation,"[66] for "[t]he critical fact is that Opinion No. 598 left those issues untouched."[67] All applicants for rehearing seem to concede the validity of that conclusion, and we continue our alliance with it.

The controversy now before us arose, it will be recalled, from administrative proceedings conducted under Section

[59] Op. text at ns.646-649.
[60] See text *supra* at notes 16-17.
[61] Op. text pt. VII.
[62] Op. text at n.657.
[63] Op. text at n.658.
[64] Op. text at n.659.
[65] Op. text at n.660.
[66] Op. text following n.660.
[67] Op. text following n.660.

7 of the Natural Gas Act.[68] Section 7 mirrors the will of Congress "that natural gas shall be sold in interstate commerce for resale for ultimate public consumption . . . at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest."[69] This objective crowns the Act's mandate that "[a]ll rates and charges" for such gas "shall be just and reasonable,"[70] and that "any such rate or charge that is not just and reasonable is declared to be unlawful."[71] The just and reasonable rate is the one and only price standard set by the Act for the gas it governs, a standard which all charges must ultimately meet.

To be sure, at least before the advent of area[72] and national[73] gas-pricing, the Commission, very properly, certificated sales of gas for which no just and reasonable rate was extant, and utilized in-line prices as initial prices pending establishment of just and reasonable rates.[74] The justification for that methodology was the unfeasibility of

[68] Act of June 21, 1938, ch. 556, 52 Stat. 824, § 7, as amended, 15 U.S.C. § 717f (1970). See Op. pt. III(A).
[69] Atlantic Ref. Co. v. Public Serv. Comm'n, *supra* note 36, 360 U.S. at 388, 79 S.Ct. at 1253, 3 L.Ed.2d at 1319. See discussion in Op. text at ns.369-373.
[70] Natural Gas Act § 4(a), 15 U.S.C. § 717c(a) (1970).
[71] *Id. See also* FPC v. Texaco, Inc., 417 U.S. 380, 394-395, 94 S.Ct. 2315, 2324-2325, 41 L.Ed.2d 141, 154-155 (1974).
[72] *See, e.g.,* Permian Basin Area Rate Cases (Continental Oil Co. v. FPC), 390 U.S. 747, 88 S.Ct. 1344, 20 L.Ed.2d 312 (1968); Mobil Oil Corp. v. FPC, *supra* note 2.
[73] See Just And Reasonable National Rates For Sales Of Natural Gas From Wells Commenced On Or After January 1, 1973, And New Dedications Of Natural Gas To Interstate Commerce On Or After January 1, 1973 (Opinion No. 699), ... F.P.C.2d .... (June 21, 1974).
[74] *See* FPC v. Sunray DX Oil Co., *supra* note 46, 390 U.S. at 37-38, 40-47, 88 S.Ct. at 1540-1541, 1542-1546, 20 L.Ed.2d at 405-406, 407-412; United Gas Improvement Co. v. Callery Properties, *supra* note 46, 382 U.S. at 226-228, 86 S.Ct. at 362-364, 15 L.Ed.2d at 288-289. See also Op. text at ns.388-391.

determining just and reasonable rates within the framework of a Section 7 certification proceeding,[75] and the consequent need for some other pricing arrangement while the usually protracted rate investigation moved forward toward ascertainment of precisely what rate would be just and reasonable.[76] The initial price in such circumstances thus functioned simply as an interim price, enduring only until the just and reasonable rate could be set and appropriate adjustments between suppliers and consumers for interim deliveries could be made.[77]

As we stated in our first opinion, however, "[i]t is evident . . . that use of the in-line price as the yardstick for the initial-price determination on certification cannot be justified in situations where a just and reasonable area rate for gas of the vintage in question has already been established."[78] We said that while the in-line price could properly be adopted as the initial price when no just and reasonable rate had been promulgated,[79] "only the presence of an overriding consideration promoting an identifiable legislative purpose can justify administrative displace-

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[75] *See* Atlantic Ref. Co. v. Public Serv. Comm'n, *supra* note 36, 360 U.S. at 389-392, 79 S.Ct. at 1253-1256, 3 L.Ed.2d at 1319-1321. See also Op. text at n.388.

[76] *See* Atlantic Ref. Co. v. Public Serv. Comm'n, *supra* note 36, 360 U.S. at 389-392, 79 S.Ct. at 1253-1256, 3 L.Ed.2d at 1319-1321. *See also* FPC v. Sunray DX Oil Co., *supra* note 46, 391 U.S. at 18-20, 88 S.Ct. at 1531-1532, 20 L.Ed.2d at 395-396; United Gas Improvement Co. v. Callery Properties, *supra* note 46, 382 U.S. at 226-228, 86 S.Ct. at 362-364, 15 L.Ed.2d at 288-289; Op. text at n.389.

[77] *See* FPC v. Sunray DX Oil Co., *supra* note 46, 391 U.S. at 19, 21-22, 25-26, 88 S.Ct. at 1531-1533, 1534-1535, 20 L.Ed.2d at 395-397, 399; United Gas Improvement Co. v. Callery Properties, *supra* note 46, 382 U.S. at 226-228, 86 S.Ct. at 362-364, 15 L.Ed.2d at 288-289. Op. text at n.391.

[78] Op. text following n.391. *Compare* Hunt Oil Co. v. FPC, 424 F.2d 982, 986 (5th Cir. 1970); Phillips Petroleum Co. v. FPC, 405 F.2d 6, 9 (10th Cir. 1969).

[79] See Op. text at ns.388-391.

ment of the just and reasonable rate through approval of another rate for gas to which the Act applies."[80] We concluded that "the Commission is legally compelled to peg a producer's initial price at a previously ascertained just and reasonable rate unless some consideration effectuating a countervailing congressional policy is shown on balance to outweigh the congressional interest in 'just and reasonable rates to the consumers of the natural gas.' "[81] In sum, it was and still is our view that absent justification of that caliber, a just and reasonable rate is to be preferred over an in-line rate as the measure of the producer's charge for gas sales authorized by a Section 7 certification.

With this position the Commission has manifested full agreement in other cases,[82] as ultimately it did in the case at bar. True it is that a majority of the Commission in Opinion No. 565 ruled that the certification should be conditioned upon an initial price geared to the in-line price for gas delivered prior to October 1, 1968, the date on which the just and reasonable rate set by Opinion No. 546 for gas of Rayne Field vintage was to take effect.[83] But a majority in Opinion No. 565-A held supersessively that the initial price should be fixed at the 1968 just and reasonable rate from the time the gas began to flow in 1959,[84] a stand wholly consistent with our own. The difficulty was that in the latter opinion the Commission also concluded

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[80] Op. text following n.396.

[81] Op. text at n.399.

[82] *See* Hunt Oil Co. v. FPC, *supra* note 78, 424 F.2d at 986; Phillips Petroleum Co. v. FPC, *supra* note 78, 405 F.2d at 9. *See also* Permian Basin Area Rate Cases (Continental Oil Co. v. FPC), *supra* note 72, 390 U.S. at 822 n.114, 88 S.Ct. at 1388-1389 n.114, 20 L.Ed.2d at 367 n.114.

[83] Texas Eastern Transmission Corp. (Opinion No. 565), *supra* note 21, 42 F.P.C. at 383-393, 403-405.

[84] Texas Eastern Transmission Corp. (Opinion No. 565-A), *supra* note 25, 44 F.P.C. at 1084, 1087-1088.

that Opinion No. 546 did not represent a final determination of just and reasonable area rates,[85] and that payments to producers should continue at the in-line price and producer refunds should be deferred until a firm area rate was forthcoming.[86]

In our previous opinion we disagreed with the Commission that the accompanying circumstances "rendered Opinion No. 546 so tentative in character as to support the Commission's refusal in Opinion No. 565-A to employ the 18.5-cent just and reasonable rate as the initial price to be paid to the producers for gas delivered after the effective date of that rate."[87] On the same ground, we disagreed with the position that that rate could not serve as the predicate for refunds by the producers on account of deliveries before that date at higher prices.[88] Our disagreement continues for the reasons which we then detailed,[89] and which now we may briefly highlight.[90] The 18.5-cent just and reasonable rate was established in a full-blown rate investigation extending over a period of seven years.[91] On applications for rehearing, the Commission again approved

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[85] *Id.* at 1087-1088.

[86] *Id.*

[87] Op. text following n.413.

[88] Op. text at ns.414-423.

[89] See Op. text at ns.414-423.

[90] The history of area ratemaking in Southern Louisiana is adequately summarized in our earlier opinion, text at ns.69-75 & pts. V(B)(2), VII, and in others. Austral Oil Co. v. FPC, *supra* note 7, 428 F.2d at 415-421; Placid Oil Co. v. FPC, *supra* note 5, 483 F.2d at 885-892; Mobil Oil Corp. v. FPC, *supra* note 2, 417 U.S. at 288-300, 94 S.Ct. at 2326-2341, 41 L.Ed.2d at 84-90. Only the status of the rates which the Commission established in the original Southern Louisiana area rate proceeding is relevant here.

[91] *See* Southern Louisiana Area Rate Proceeding, 25 F.P.C. 942 (1961) (order instituting proceeding); Southern Louisiana Area Rate Proceeding (Opinion No. 546), *supra* note 7.

that rate,[92] although later it prepared to take another look at it.[93] On appeal to the Fifth Circuit, the rate determinations in Opinion No. 546 were "sustained in full,"[94] though with leave to the Commission to reopen its order and revise the rates in light of new evidence.[95]

That was the situation when the Commission issued Opinion No. 565-A.[96] It seemed to us that the 18.5-cent rate

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[92] Southern Louisiana Area Rate Proceeding (Opinion No. 546-A), *supra* note 7, 41 F.P.C. at 306-309. The Commission felt that the importance of more abundant gas supplies from offshore areas of Southern Louisiana called for a new investigation of the adequacy of price ceilings for offshore gas, *id.* at 307-308, but that "[t]he reasons for instituting a new proceeding do not apply to the onshore prices at this time." *Id.* at 308. It was nearly nine months later that the onshore ceilings were brought into the new investigation. See Op. text at ns.406-408.

[93] See note 92, *supra.*

[94] Southern Louisiana Area Rate Cases (Austral Oil Co. v. FPC), *supra* note 7, 428 F.2d at 444.

[95] *Id.* at 444-445. See also Op. text at ns.409-413 & n.413. The court clearly contemplated that these rates remain in effect while the new rate investigation proceeded, for it stated that "[t]he maximum rates which the Commission has set . . . are to remain in effect throughout the new proceeding, which may last for years." 428 F.2d at 421 n.27. The fact is however, that by reason of administrative and judicial stays these rates never actually operated. *See* Mobil Oil Corp. v. FPC, *supra* note 2, 417 U.S. at 298, 94 S.Ct. at 2340, 41 L.Ed.2d at 89.

[96] Slightly more than two months after announcement of Opinion No. 565-A, the Supreme Court declined to review the Fifth Circuit's decision in the Southern Louisiana Area Rate Case (Austral Oil Co. v. FPC), *supra* note 7, 400 U.S. 950, 91 S.Ct. 244, 27 L.Ed. 2d 257 (1970) (denying certiorari). It was nearly a year after Opinion No. 565-A, in which the Commission decided to await the outcome of the new investigation, before it issued its decision therein. Southern Louisiana Area Rate Proceeding (Opinion No. 598), *supra* note 5. Finding the terms of a settlement proposal endorsed by numerous parties to be just and reasonable and supported by substantial evidence in the extensive administrative record amassed, the Commission set new rates, effective August 1, 1971, higher than those fixed in Opinion No. 546. 46 F.P.C. at 103-110, 135-138, 142-143. The Commission also prescribed a formula for refunds consequent upon deliveries of gas prior to that date. *Id* at 140-141, 146-148. With that, the Commission declared

differed insufficiently from any other rate — which inherently would be subject to change in the public interest — to lose its character as the legally appropriate criterion for the initial price which the producers in suit thenceforth would be allowed to exact,[97] and for the measurement of refunds occasioned by past exactions.[98] We accordingly held "that neither the susceptibility of the 18.5-cent area rate to modification upon [an appropriate] finding nor the ongoing administrative inquiry into the propriety of such a finding was adequate justification for the Commission's decision in Opinion No. 565-A to ignore it."[99]

We recognize that in consequence of administrative and judicial stays the 18.5-cent rate never went into general operation[100] but that, we think, is immaterial. The question was not whether Rayne Field producers were limited in their charges by the rate per se, but whether their initial prices should have been fixed and their refunds calculated in accordance with that rate pending either its reaffirmation or promulgation of a new rate. The fact that producers selling gas at previously Commission-approved prices were unaffected by the stayed 18.5-cent rate did not answer the question whether that rate, in lieu of the in-line price, should have been taken as the point of reference for initial prices and refund obligations for producers whose sales until then were entirely unregulated. While, when Opinion No. 565-A was announced, the 18.5-cent rate was in suspension as an operative price ceiling, it nonetheless represented the Commission's considered and best judgment as

that Opinions Nos. 546 and 546-A — the original Southern Louisiana area rate prescriptions — "now perform no office." 46 F.P.C. at 102.

[97] Op. text at ns.414-423.

[98] Op. text at ns.472-475 & pt. V(D)(2).

[99] Op. text following n.423.

[100] See note 95, *supra*.

to what a just and reasonable charge for Rayne Field gas should be.

The same could not be said for the in-line price — the going field price[101] — for which the Commission opted instead. As we said in our first opinion, the Supreme Court has warned that where the Commission has decided "to rely solely upon contemporaneous contract prices in setting initial rates, there can be no assurance that an initial price arrived at by the Commission will bear any particular relationship to the just and reasonable rate."[102] And even subsequent to announcement of our opinion, the Court has similarly declared that "the prevailing price in the marketplace cannot be the final measure of 'just and reasonable' rates mandated by the Act.[103] We reiterate that the in-line price for Rayne Field gas would have been the legitimate benchmark for the initial producer-price and for the initial producer-refund had the Commission been unable to more closely approximate the just and reasonable rate.[104] We remain of the view, however, that with the still unrevised 18.5-cent just and reasonable area rate available, the Commission was legally obligated to give it preference. It bears repeating that Congress has specified that "[a]ll rates and charges" for jurisdictional gas "shall be just and reasonable,"[105] that "any" other such rate is unlawful,[106] and that the Commission's duty was to fix the producers' initial price "at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest."[107]

[101] See Op. text at n.44.

[102] Op. text at n.393, quoting FPC v. Sunray DX Oil Co., *supra* note 46, 391 U.S. at 25, 88 S.Ct. at 1535, 20 L.Ed.2d at 399.

[103] FPC v. Texaco, Inc., *supra* note 71, 417 U.S. at 397, 94 S.Ct. at 2326, 41 L.Ed.2d at 156.

[104] See Op. text at ns.460-461.

[105] See text *supra* at note 70.

[106] See text *supra* at note 71.

[107] See text *supra* at note 69.

We think these provisions preclude the Commission, when setting initial rates and computing initial refunds from settling for second best.[108]

Petitions denied.

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[108] The Commission requests clarification of our directions regarding flow-through to Texas Eastern's customers of producer refunds accruing to Texas Eastern prior to the effective date of the 1971 area rate. See Op. text at ns.673-676. In Opinion No. 565, the Commission formulated a flow-through plan which we deemed objectionable only to the extent that it utilized the 20-cent in-line price as the basis for computations for part of the relevant period instead of the 18.5-cent area rate throughout. Op. pt. VI(G). In Opinion No. 565-A, however, the Commission deferred the matter of refund flow-through in its entirety, and we held that it erred in doing so. Op. text at ns.635-638, 669-670. We said that the Commission must calculate, after due regard for Texas Eastern's Rayne Field investment, the amount to be flowed through on the basis of the 18.5-cent rate, and after updating the computation must order flow-through as soon as practicable. Op. text at ns.673-676. The Commission asks whether on remand it has discretion to refashion, in some undisclosed manner, the flow-through plan, or whether it must employ the plan it constructed in Opinion No. 565.

It was not our purpose to bind the Commission to the flow-through methodology specified in Opinion No. 565, even as revisable in light of our criticism. We reviewed that methodology because some of the parties attacked it and, since the Commission did not disapprove it in Opinion No. 565-A, because it thus appeared that the Commission might still resort to it eventually. See Op. pt. VI(G). But we took pains to state that we did not proceed "on the broad premise that invalidity of an administrative decision undertaking to change an earlier administrative decision invariably reinstates the earlier decision," but in the realization "that the agency may legally have a choice as to the action it will take in the matter, and that a court may not be able to say that the agency, had it known that the latter decision would not pass judicial muster, would have left the earlier decision as its final action." Op. text following n.558. See also note 42, *supra*. We added our recognition "that the refunding aspects of Opinion No. 565 may have lost their vitality by reason of supersession by the suspension provisions of Opinion No. 565-A, notwithstanding the invalidity of the latter." Op. text at n.627. It is for the Commission, not us, to say whether in properly revised form the Opinion No. 565 flow-through plan survives, and if not just what, within the limitations we imposed, the plan shall be.

APPENDIX D

JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT ENTERED ON MARCH 25, 1974

UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT

SEPTEMBER TERM, 1973

No. 24,716

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

TEXAS EASTERN TRANSMISSION CORPORATION,
SUN OIL COMPANY, GENERAL CRUDE OIL COMPANY,
CONTINENTAL OIL COMPANY AND M. H. MARR,
Intervenors

No. 24,823

SUN OIL COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

TEXAS EASTERN TRANSMISSION CORPORATION,
PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION,
Intervenors

No. 24,823

GENERAL CRUDE OIL COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

TEXAS EASTERN TRANSMISSION CORPORATION,
PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION,
Intervenors

No. 24,824

GENERAL CRUDE OIL COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

TEXAS EASTERN TRANSMISSION CORPORATION,
PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION,
Intervenors

No. 24,825

M. H. MARR,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

TEXAS EASTERN TRANSMISSION CORPORATION,
PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION,
Intervenors

No. 24,836

CONTINENTAL OIL COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

TEXAS EASTERN TRANSMISSION CORPORATION,
PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION,
Intervenors

No. 24,846

TEXAS EASTERN TRANSMISSION CORPORATION,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

SUN OIL COMPANY, CONTINENTAL OIL COMPANY,
M. H. MARR AND GENERAL CRUDE OIL COMPANY,
PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION,
Intervenors

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

SEPTEMBER TERM, 1973

No. 24,716 etc.

PETITIONS FOR REVIEW OF ORDERS OF THE FEDERAL POWER COMMISSION

Before: FAHY, *Senior Circuit Judge,*
TAMM and ROBINSON, *Circuit Judges.*

JUDGMENT

These causes came on to be heard on petitions for review of orders of the Federal Power Commission and were argued by counsel. On consideration of the foregoing, it is

Ordered and Adjudged by this Court that the orders of the Federal Power Commission on review herein are affirmed in part, and reversed in part and these cases are hereby remanded to the Commission for further proceedings consistent with the opinion filed herein this date.

Per Curiam

For the Court

Hugh E. Kline
Hugh E. Kline, Clerk

Date: March 25, 1974

Opinion for the Court filed by Circuit Judge Robinson.

APPENDIX E

ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT DENYING REHEARING FILED AUGUST 27, 1975

UNITED STATES COURT OF APPEALS

FOR THE DISTRICT OF COLUMBIA CIRCUIT
SEPTEMBER TERM, 1974

No. 24,716

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

No. 24,823

SUN OIL COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

No. 24,824

GENERAL CRUDE OIL COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

No. 24,825

M. H. MARR,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

No. 24,836

CONTINENTAL OIL COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

No. 24,846

TEXAS EASTERN TRANSMISSION CORPORATION,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

Before: Fahy, Senior Circuit Judge; Tamm and Robinson, Circuit Judges

ORDER

Upon consideration of the petitions of the Federal Power Commission, Continental Oil Company, Sun Oil Company, M. H. Marr and General Crude Oil Company for rehearing, it is

ORDERED by the Court unanimously that the petitions be and hereby are denied.

Per Curiam

For the Court:
HUGH E. KLINE, Clerk

By: ROBERT A. BONNER
Robert A. Bonner
Chief Deputy Clerk

APPENDIX F

OPINION NO. 565, "OPINION AND ORDER GRANTING CERTIFICATES WITH CONDITIONS AND REQUIRING REFUNDS" OF THE FEDERAL POWER COMMISSION ISSUED AUGUST 6, 1969

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Texas Eastern Transmission Corporation	Docket No. G-12446
Continental Oil Company	Docket No. CI66-890
Sun Oil Company	Docket No. CI66-891
M. H. Marr	Docket No. CI66-892
General Crude Oil Company	Docket No. CI66-919

OPINION NO. 565

OPINION AND ORDER GRANTING CERTIFICATES WITH CONDITIONS AND REQUIRING REFUNDS

Issued: August 6, 1969

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Texas Eastern Transmission Corporation	Docket No. G-12446
Continental Oil Company	Docket No. CI66-890
Sun Oil Company	Docket No. CI66-891
M. H. Marr	Docket No. CI66-892
General Crude Oil Company	Docket No. CI66-919

OPINION NO. 565

APPEARANCES

David T. Searls, J. Evans Atwell and *Jack D. Head* for Texas Eastern Transmission Corporation

Bruce R. Merrill and *Joseph C. Johnson* for Continental Oil Company

Herf M. Weinert and *Robert E. May* for Sun Oil Company

F. W. Reese for M. H. Marr

W. M. Streetman and *Harry R. Jones, Jr.*, for General

Crude Oil Company

Bertram D. Moll for Long Island Lighting Company

J. Harry Mulhern, Edward S. Kirby and *James R. Lacey* for Public Service Electric & Gas Company

Robert W. Maris, William T. Coleman, Jr. and *Edward F. Mannino* for Philadelphia Gas Works Division of the United Gas Improvement Company

Sidney M. Schreiber for New Jersey Natural Gas Company

Halcyon G. Skinner and *G. S. Peter Bergen* for Consolidated Edison Company of New York, Inc.

Morton L. Simons for Philadelphia Electric Company

Morton L. Simons and *Kent H. Brown* for the Public Service Commission of the State of New York

Norman A. Flaningam, Charles R. Brown and *C. William Cooper* for Consolidated Natural Gas Service Corporation

Thomas J. Roderick for The East Ohio Gas Company

Thomas A. White for Consolidated Gas Supply Corporation

Henry A. Jackson for Peoples Natural Gas Company

Edwin F. Russell and *Barbara M. Suchow* for The Brooklyn Union Gas Company

George P. Lewnes, Stephen Chesnoff and *James P. Green* for the Staff of the Federal Power Commission

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

CERTIFICATES (Independent Producer), CERTIFICATES (Lease Sale), CERTIFICATES (Conditioned), REFUNDS (Independent Producer), REFUNDS (Lease Sale), REFUNDS (Flow-through), ACCOUNTING, RATES (Pipeline)

Before Commissioners: Lee C. White, Chairman; L. J. O'Connor, Jr., Carl E. Bagge, John A. Carver, Jr., and Albert B. Brooke, Jr.

	Docket No.
Texas Eastern Transmission Corporation	G-12446
Continental Oil Company	CI66-890
Sun Oil Company	CI66-891
M. H. Marr	CI66-892
General Crude Oil Company	CI66-919

OPINION NO. 565
OPINION AND ORDER GRANTING CERTIFICATES WITH CONDITIONS AND REQUIRING REFUNDS

(Issued August 6, 1969)

O'CONNOR, Commissioner:

1. In this proceeding the Producers, Continental Oil Company, Sun Oil Company, M. H. Marr, and General Crude Oil Company have applied for certificates to sell gas from the Rayne Field pursuant to a lease-sale arrangement with Texas Eastern Transmission Corporation, which became effective in 1959. The Commission approved a procedure proposed by the Presiding Examiner, Arthur H.

Fribourg, by which the hearing was conducted in two phases. The first phase, among other things, concerned the question of certificates and rates for the future while the second phase concerns refunds by the Producers, the proper entitlement thereto and prospective rate adjustments by Texas Eastern. After the issuance of the Examiner's decisions on January 23, 1968, and September 11, 1968, the two phases were consolidated by order of September 26, 1968, to permit one Commission decision on both phases.

2. Originally, Texas Eastern and the Producers had sought certificates to effect a conventional sale from the Rayne Field reserves. The initial price to Texas Eastern was to be 22.6 cents per Mcf plus 1.3 cents tax reimbursement. While the matter was pending before the Commission, Texas Eastern filed a petition to reopen the hearing and amend its application alleging that certain of the producers had cancelled their contracts and that negotiations were proceeding towards a new arrangement. This was embodied in a lease-sale agreement dated December 4, 1958, by which the Producers were to transfer to Texas Eastern rights to gas in place. In accordance with this agreement the Producers on July 27, 1959, assigned and conveyed to Louisiana Gas Corporation, an affiliate of Texas Eastern, certain oil and gas leases, gathering lines and other equipment in the Rayne Field. The consideration was to be $134,395,700, of which $12,420,500 was paid in cash and the remainder in serial notes signed by Louisiana Gas payable in monthly installments to each of the Producers over a 16-year period ending in 1975 although the life of the field was expected to extend to 1986. In addition, the Grantee was to make a monthly "production payment" to the Producers representing the proceeds of condensate liquids less costs for operating the field until 613,406,770 Mcf of gas has been produced. Under a management agreement Continental would operate

the field, receiving as compensation costs plus a fee of $4,000 per month. On the same day that it received the leases Louisiana Gas transferred them to Texas Eastern, to which we shall refer as including the interests of Louisiana Gas.

3. As will be developed, the most important feature of this agreement is that the payments are made during the first sixteen years while the life of the field promises to be much longer. Therefore, it is uncontroverted that during the early years of the contract Texas Eastern's payments when matched with the volumes of gas received, even without considering other Texas Eastern costs, result in a price per Mcf that is above the in-line price of 20 cents in Southern Louisiana. For the years 1959-1967, the price including only the down payment and notes, would be about 23.5 cents per Mcf, while after 1975 when the note paying period terminates Texas Eastern would obtain the gas by the payment of certain costs (royalties, severance taxes and operating expenses), offset by what it would receive from salvage and revenue from liquids produced.

4. On June 23, 1959, the Commission approved the transaction unconditionally (21 FPC 860), and from the time of the conveyance on July 27, 1959, Texas Eastern has been receiving gas from the field, which it has been transporting and selling to its customers. However, the Commission's opinion was reversed in *P.S.C. of N.Y.* v. *F.P.C.*, 287 F.2d 143 (CADC 1960), because of its failure to consider adequately the reasonableness of the cost to the pipeline.

5. On remand the Commission on February 6, 1963, in Opinion No. 378 determined that it had jurisdiction over the lease-sale transaction and disapproved the arrangement saying (29 FPC 249, 256) the arrangement "did not envision adjustments from time to time to comply with FPC rate regulation and it is indeed difficult to envision how we could exercise our regulatory authority within the framework of such an arrangement." The Commission concluded that the arrangement would "make it difficult if not impossible to subject to regulatory control the price for the sale to an interstate pipeline of this large body of gas . . . and that the transaction is not in the public interest as a way to acquire gas supplies." The Commission gave the parties "opportunity to work out new arrangements."

6. However, on rehearing the Commission denied that it was attempting to reform the contracts and said: (30 FPC 153, 156)

> "We did not intend to order the parties to execute a particular kind of contract, or any contract, apart from the necessity of completing the present proceedings."

7. Although reversed in the Court of Appeals (336 F.2d 320), the Commission's finding of jurisdiction was upheld in *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (June 1, 1965).

8. Since the sale had been found jurisdictional, the Producers, on March 24, 1966, filed applications for certificates, presenting the lease-sale arrangement in its original form, but on March 10, 1967, each filed an agreement dated March 3, 1967, to reimburse the pipeline at 20.625 cents per Mcf[1] for the amount by which the production from the field eventually falls short of 814,339,000 Mcf.

9. Based only on the Producers' direct evidence and briefs the Examiner on January 23, 1968, issued his initial decision in Phase I granting certificates to the Producers and Texas Eastern. He did not reject the lease-sale arrange-

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[1] Amounts will be stated at 15.025 psia.

ment, but sought to modify it so that the economic effect on the buyer would be equivalent to a conventional sale at the "in-line" price of 20 cents which he found to be applicable in Southern Louisiana. He specified that after the effective date of his order no payment by Texas Eastern should amount to more than 20 cents per Mcf, subject to certain adjustments.

10. The 20 cent price was to be reduced by costs incurred by Texas Eastern covering items that in a conventional sale would be borne by the Producers. These comprise (a) royalties (b) state taxes, (c) costs for development or operation of the field except those reimbursed to Texas Eastern through liquid revenues. The price would be increased by items from which Producers normally benefit comprising (d) liquids produced after completion of the production payments, (e) salvage realized by Texas Eastern from any investment in the field, and (f) value at time of completion of the production payment of liquid handling facilities.

11. After the presentation of further evidence, hearings, including cross-examination and the exchange of briefs, the Examiner on September 11, 1968, issued his decision in Phase II. As in Phase I he found that the basic flaw of the lease-sale arrangement included estimates of liquid production and other risk factors, that to wait for a decade or two to see whether the unbalance in payments for gas during the early years of the contract adjusts itself is not required by the public convenience and necessity, and that only if the proposal is equated to a conventional sale can it be both fairly and feasibly regulated.

12. He computed refunds for the period 1959-1967 using as a basis the 20 cent in-line price with the adjustments he found necessary in Phase I to place the transaction on a

conventional basis. Using this method he found that Texas Eastern had made overpayments amounting to $21,854,000 without interest. Interest at 6 percent to March 1, 1960 and at 7 percent through 1967 would amount to $9,595,000, making a total of $31,449,000. While Texas Eastern asks that the refunds be used as a credit to its purported investments in the Rayne Field, the Examiner, believing that Texas Eastern's disbursements on Rayne Field should be considered payments for gas, required that such investments be written off to surplus.

13. The Examiner also found there was no reason to permit Texas Eastern to retain the refunds and ordered that they be paid into an escrow account pending a determination of those entitled to them. Based on the reduction of the costs of Rayne Field gas to 20 cents as adjusted by his Phase I decision, he ordered that Texas Eastern reduce the commodity component in its systemwide rates by 0.2 cents per Mcf.

14. Upon consolidation of the two phases by our order of September 26, 1968, exceptions filed by the Producers (with an additional brief by Mar , Texas Eastern, Philadelphia Gas Works and Public Service Electric and Gas Company (PGW) and the Eastern Intervenors (Brooklyn Union Gas Company, Philadelphia Electric Company and Public Service Commission of New York), and briefs opposing exceptions by the New York Commission, Texas Eastern, Brooklyn Union Gas Company, PGW, the Producers and the staff, both phases of the proceeding are now before the Commission for determination.

THE PUBLIC CONVENIENCE AND NECESSITY OF THE LEASE-SALE TRANSACTION

15. The primary question in this proceeding is whether

the proposed lease-sale transaction, resubmitted by the applicants for certification after our determination that it constituted a jurisdictional sale, conforms to the public convenience and necessity under the standards of the Natural Gas Act. It is clear that the Act is concerned broadly with the "public interest" but is particularly directed to the "ultimate distribution" of gas to the public (Section 1(a)). As said in the *CATCO* case[2] "The Act was so framed as to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges." Here we have before us the task of weighing the interests of the Producers who are transferring the leases and selling the gas, Texas Eastern, which is purchasing the gas and transporting it, and Texas Eastern's customers and their customers, who will consume it. These disparate interests must be reconciled, if possible, within the mandate of the Statute.

16. As indicated above, the Examiner held the standard of the Act had not been met. In so concluding, he found it unnecessary to compare the overall benefits to the consumer of the lease-sale arrangement with a conventional sale because he believed that, even with the reserve guarantee described above, there were too many remaining uncertainties with respect to estimates of future operating practices and costs and the prices for liquids, upon which any evaluation of the comparative value of the lease-sale would necessarily be based, to permit any certainty of result. He concluded that it was contrary to the public convenience and necessity to permit the gas consumer to assume these risks.

17. We agree with the Examiner that the guarantee, standing alone, does not remove much of the uncertainty of the lease-sale arrangement; there are numerous other

[2] *The Atlantic Refining Co.* v. *P.S.C. of N.Y.*, 360 U.S. 378, 388 (1959).

factors which can have a substantial impact upon the cost of the gas to Texas Eastern and its customers under the lease-sale, such as the value and quantity of the liquids, the rate of production of the gas and liquids, the rate of return Texas Eastern is entitled to throughout the life of the wells, and associated taxes, variations in operating expenses and uncertainty of delivery. If we were considering the proposed contract in an executory stage, these uncertainties in and of themselves might well be sufficient to require rejection of the lease-sale.

18. However, as of the end of 1968, almost half of the estimated recoverable gas (and the gas guaranteed by the Producers) had already flowed into Texas Eastern's lines and most of the agreed-to note payments have already been made. Under these circumstances, we agree with the Producers and Texas Eastern that it would be appropriate to compare the estimated cost of the lease-sale as a whole to Texas Eastern and its customers with the cost of a conventional gas purchase arrangement. In making this comparison, however, we must keep in mind the continuing substantial uncertainties as to the lease-sale arrangement and could only find it is required by public convenience and necessity, as contrasted with a conventionalized sale, if the comparison were significantly in its favor. As we shall see, the comparison is not favorable to the lease-sale, even without considering the uncertainties thereof.

19. Any such comparison presents a threshold question as to the price at which a conventional sale should be calculated. There is no doubt that deliveries of gas after October 1, 1968, (the effective date of our decision in AR61-2)[3] should be valued at the 18.5 cent per Mcf price

[3] *Area Rate Proceeding,* 40 FPC 530, Docket Nos. AR61-2, *et al.* issued Sept. 25, 1968; Order on rehearing, ... FPC ......, issued March 20, 1969.

found to be the just and reasonable price for gas under contracts of this vintage for areas subject to the Louisiana taxing jurisdiction. The question is whether for earlier periods the gas should be evaluated at this price or at the "in-line" price for gas of this contract vintage, which the Examiner, for purposes of refund, fixed at 20 cents per Mcf.

20. The Producers have excepted to the Examiner's determination that 20 cents is the appropriate "in-line" price for gas sold under 1958 contracts, but for the reasons given in the Examiner's opinion we think the 20 cent price is clearly consistent with both the evidence of record and the controlling precedents.[4] The New York Commission, citing the Supreme Court's recent decision in the *Sunray DX Oil Co.* v. *F.P.C.,* 391 U.S. 9 (1968), contends that having fixed the just and reasonable price for the gas before completing action on the permanent certification of the sale involved in this case there is no basis for applying the in-line rationale for valuing the gas which has actually flowed into Texas Eastern's lines since 1959. We do not agree.

21. The Supreme Court in *Sunray* emphasized that the price determination in a certificate case performs a dual function, as an initial price from which any increases will be subject to the ratemaking procedures of Section 4 of

[4] *Continental Oil Co.,* (CATCO), *et al.,* 27 FPC 96; *United Gas Pipe Line Co.,* 30 FPC 329; *Placid Oil Co.,* 30 FPC 283; *Union Texas Petroleum, et al.,* 32 FPC 254; *Superior Oil Co.,* 32 FPC 241. In *Placid* the Supreme Court specifically found that the 18.5 cent price was supported by the evidence. *United Gas Improvement Co.* v. *Callery Properties, Inc.,* 382 U.S. 223 (Dec. 7, 1965). However, in reviewing *Union* the Tenth Circuit found insufficient support for limiting the tax reimbursement to 1.5 cents. *Pan American* v. *F.P.C.,* 376 F.2d 161 (CA10 Jan. 1967). Remanded for further consideration in *F.P.C.* v. *Pan American,* 391 U.S. 363; on remand *Union Texas Petroleum,* ...... FPC ......, Docket No. G-13221, *et al.,* Dec. 18, 1968.

the Act and as a refund floor, and that "since an initial price and a refund floor conceivably may serve significantly different ends," they should be separately considered, 391 U.S. 9, at 24. Dealing with the certificate price as a refund floor, the Court indicated its belief that "logically" it would appear that complete consumer protection could only be achieved by a condition "rending the producer liable for refunds down to the just and reasonable rate, should that rate prove lower than the initial rate specified in the certificate (id. at 36). But the Court recognized that the Commission had not in the past so acted nor had the courts suggested that the Commission impose such conditions. And it noted that in the *Callery*[5] case, involving the same area and contracts of approximately the same vintage as those involved here, the Court had expressly approved refunds to the in-line price — in so doing reversing a contrary determination by the court of appeals. "[I]n the light of *Callery* and the other precedents," the Court held, "the Commission was not obliged in this instance to give explicit consideration to the establishment of a distinct refund floor" (*id.* at 37). It noted that the same factors were present in *Sunray* as in *Callery,* the "need to speed refunds to the consumers and to assure Producers of a firm price" (*ibid.*).

22. One of these two factors clearly is not presented in the present proceeding; since the just and reasonable rate is now determined for gas of this vintage, it will not necessarily speed refunds to use the 1959 in-line price as the measure of refunds rather than the lower just and reason-

[5] *United Gas Improvement Co.* v. *Callery Properties, Inc.,* 382 U.S. 223.

able rate.[6] We think, however, that while use of the 20 cent in-line price as a refund floor cannot serve, as in *Callery*, to assure these Producers a firm minimum price for the future, in a very real sense it serves the same objective of producer certainty. For, unless we are to treat the present sale in the same manner as those contemporaneously contracted for and certificated at the in-line price of 20 cents per Mcf, we will in effect be punishing the producers for litigating their by no means frivolous legal and policy claims in the courts and before this Commission. This in our view would not only be inequitable. but would necessarily lead to unnecessary producer uncertainty when they choose to dedicate gas to the interstate market. Obviously, where their claims to special consideration are rejected they should not benefit by the passage of time in the course of their litigation. But where contemporary sales in the same area have been permanently certificated at in-line prices, approved by the courts, and used for both in-line and refund purposes, we do not believe that the exigencies of the timing of litigation on similar sales should lead to a different result.

23. In his statement the Chairman believes that our opinion would give the determination of just and reasonable rates on September 25, 1968, in AR61-2 prospective effect only. We intend no such result here. This is not a rate case where we are concerned with possible refunds by producers who have filed increased rates prior to the issuance of our area rate. Here we are issuing a certificate under Section 7 of the Natural Gas Act. Section 7(c)

[6] While the just and reasonable price is the subject of further review, and refunds have been stayed pending such review, it seems equally clear that our decision here and the refunds ordered — whatever their nature — will be the subject of court review and possible stay.

provides that we have power to attach to the certificate "such reasonable terms and conditions as the public convenience and necessity may require". We think it reasonable, as provided below, to require that the Producers reduce their rates prospectively to an effective 18.5 cents per Mcf in accordance with AR61-2.

24. With respect to refunds there is no requirement in Section 7 that they be ordered. It is a question of whether we have properly exercised our discretion. See *F.P.C.* v. *Sunray DX Oil Co.*, 391 U.S. 9, 46 (1968). In *P.S.C. of New York* v. *F.P.C.*, 329 F.2d 242 (CADC 1964), certiorari denied 377 U.S. 963, the court adopted our standard of equity in determining whether a refund should be ordered, but found that we had applied it wrongly in that case. Therefore ordering a refund in this certificate proceeding based on the in-line price of 20 cents rather than the just and reasonable price of 18.5 cents does not mean that the 18.5 cent price will have only prospective effect, but represents only the equities arising from the peculiar circumstances in this certificate proceeding. The comparison made by the Chairman with a producer who charged rates higher than 18.5 cents during any part of the 1954-1968 period pursuant to increased rate filings allowed to become effective subject to refund after suspension is therefore, in our opinion, not in point.

25. The Chairman says that we are attempting to place the producers in their 1959 status rather than issuing certificates which meet the requirements of today and that we are putting a premium on delaying certification. Certificates in this proceeding cannot be issued without doing justice to all parties, including the consumers of gas, and this requires consideration of what has already happened. The first time this proceeding was before us in 1959 we approved the transaction; the second time it was before

us after remand in 1963 we condemned its form but afforded the parties opportunity to file new arrangements, and, on rehearing, denied we were requiring the parties to execute any particular kind of contract. In the present proceeding the lease-sale has again been presented to us. By this time a large part of the gas has been delivered and payment made. Various advantages are available to the parties — among others, tax benefits to the Producers, a flexible supply of gas for Texas Eastern, and, as provided below, if there is sufficient gas in the Field, a benefit to the consumers in purchase price free gas after the purchase price has been paid and Texas Eastern has been compensated for its outlays of funds. We have been partly responsible for this extended consideration of the lease-sale arrangement. When it first came before us, we might have denied it finally or conditioned it in such a way that our action would have satisfied the Court. Our original failure to consider the problem fully led to the first remand. On review of this history and the present relations of the parties we think it equitable to treat the Producers as though they had been granted a certificate when the delivery of gas commenced at the in-line price of 20 cents per Mcf.

26. As the Chairman states, whether the producer refund is computed on the basis of 18.5 cents per Mcf or 20 cents per Mcf the Producers would, in any case, receive the full contractual purchase price of $134,395,700 and, looked at another way, the consumers would pay the same amount in either case. With a larger refund, it would merely take longer for the Producers to receive from Texas Eastern the full purchase price as gas is delivered at the effective price of 18.5 cents per Mcf, and consumers would not have to pay the full costs as soon as they otherwise would. The larger refund would reduce the possibility of there being any residual gas, for which no payment would

be required, and therefore the possibility of consequent benefit to the consumers.

27. Even with a 20 cent per Mcf valuation for the gas taken into Texas Eastern's system before October 1, 1968, the comparison of effective cost to Texas Eastern and its customers greatly favors the conventionalized approach adopted by the Examiner. The total cost of the gas to Texas Eastern under the lease-sale arrangement is of course substantially more than the $134,395,700 in payments. As the Examiner found, it includes royalty payments, severance taxes, unreimbursed operating expenses, and unreïmbursed capital expenditures over and beyond what it would pay under a conventionalized gas purchase contract, from which sums must be deducted salvage value and estimated liquid revenues after the end of the contract period. As set out in Appendix A hereto, these amounts, using figures supplied by the Producers and assuming the rates of take of gas and liquids estimated by them, and that the present prices for sales of liquids will be maintained, would amount to some $168,900,000[7] over the life of the property as an active gas field. In contrast, payment for the estimated amount of recoverable gas at a price of 20 cents per Mcf for the gas delivered into Texas Eastern's lines up to October 1, 1968, and 18.5 cents per Mcf thereafter will cost a total of $186,537,000.[8] This apparent saving from the lease-sale arrangement, however,

[7] For purposes of comparison and argument it was assumed that the 22.6 cent basis for the royalty paid by Texas Eastern under the lease-sale transaction would be reduced to the area of 18.5 cents per Mcf as of October 1, 1968.

[8] This amount would, of course, not all be paid to the Producers under the conventional scheme proposed by the Examiner. Instead, there would be deducted sums to take care of the royalty payments, severance taxes, and extra operating and capital expenses borne by Texas Eastern, and added the liquid revenues it will receive, plus salvage value of the property.

fails to consider the time value of money resulting from the fact that much of the lease-sale cost was met by a large down-payment, and all of the note payments to the Producers will, under the lease-sale contract, have been made by 1975. In other words, the Producers have, in effect, had their money in advance and Texas Eastern and its customers have had and would (but for this opinion and order) continue to have to bear the very real costs of paying for gas well in advance of securing it. When we take the time value of the advance payments into account by discounting the sums payable under the two alternatives back to 1959, when deliveries first began, a very different picture is presented. Thus, at a constant 5 percent discount rate, the discounted cost of the lease sale is $122,403,000 against only $116,270,000 for the conventional approach. And this difference of over $6,133,000 is even greater if a 6 percent discount rate is utilized.

28. Producer witness O'Leary states that the Producers would realize net revenues of only 16.756 cents per Mcf over the term of the lease-sale contract. He started with the price to the four sellers of $134,395,700. He added $21,130,158, largely representing Louisiana severance taxes, and subtracted $20,715,216, largely representing liquid revenues that Texas Eastern would receive. He divided the result by 804,555,000 Mcf representing the four party interest in the gas to obtain his price per Mcf of 16.756 cents. However, his analysis does not reflect the time value of money, omits the costs incurred by Texas Eastern in producing the gas and does not take into account the 22.6 cent cost to Texas Eastern of royalty gas.

29. Producer witness Conkling computed Texas Eastern's Rayne Field costs over the life of the field and found them to amount to 19.834 cents per Mcf. Under his method he discounted the note payments back to the commencement of deliveries (at a 5 percent discount rate), added the down payment, and applied a 6¼ percent rate of return to the investment basis so computed. He added various expenses and deducted, as we did, a $19,745,516 credit for liquid revenues for the period after the production payments estimated to end in 1975.

30. In our opinion witness Conkling's approach is not comparable to the one used by us since it does not take into account the time value of money with respect to all items bearing on the cost of gas over the life of the Field. Thus the witness did discount the note payments back to 1959 to develop his rate base, but he did not discount other items in the cost of service including the $19 million in net liquid credits. Since these fall in the latter part of the contract period, they would be heavily discounted in relation to the costs. Not discounting them, therefore, would underestimate the cost of gas covered by the lease-sale arrangement.

31. In Phase II of the proceedings Producer witness Gamble undertook to show the position in which the parties would have been if the sale had been a conventional sale at 18.5 cents per Mcf. As the witness explains, in a conventional arrangement the seller bears all the costs of production and retains all the liquids. By deducting Texas Eastern's unreimbursed costs but adding the value of the liquids to which it is entitled the witness shows that for a payment of $134,396,000 under the lease-sale contract it is getting value amounting to $163,885,000. The witness then discounts these payments at 5 percent back to 1959 to give effect to the time value of money, and finds that the value under lease-sale would be approximately the same as at a price of 18.5 cents per Mcf. In his computations, however, he does not take into account severance

taxes amounting to about $18,500,000 that Texas Eastern would pay over the life of the field.

32. To conclude, the lease-sale arrangement produces a lack of certainty over the life of the field and, as the record indicates, a higher cost than a conventional sale at 20 cents per Mcf. Because of these features of the lease sale transaction, it is imperative for the Commission to take steps within its jurisdiction, which will protect consumers from paying excessive rates. This can be done, we believe effectively, through regulating the payments made by Texas Eastern to the Producers by conditioning the lease-sale arrangement. However, we do not think it necessary to reject the whole arrangement, which may have tax advantages to the parties. Accordingly, we shall adjust the arrangement so that, up until the entire purchase price of $134,395,700 is paid by Texas Eastern, it will be equivalent in economic effect to a conventional sale at the just and reasonable price of 18.5 cents per Mcf. After that, as proposed by the Applicants, Texas Eastern would make no further payment, for if we required continued payments until the Field was exhausted the lease-sale would be, in effect, converted into a conventional sale, presumably with the corresponding tax consequences. To accomplish these ends will clearly involve a reduction of the payments for gas and an extension of the paying period, but the Producers would eventually receive the full purchase price of $134,395,700, although over a longer period, even after making the refunds which we order below.

33. The contention is made by the Producers as well as by Commissioner Carver's dissent that the lease-sale transaction is endowed with certain unique features that should be taken into account such as freedom from price escalation, increased flexibility of operations for the pipeline,

adjacency of the reserves and the size of the reserves. In general, the Commission in producer certificate proceedings has not made allowances for special contract provisions. Compare: *Cox,* 32 FPC 1301, 1307 (1964); *Medina Gathering,* 30 FPC 227, 231 (1963); *California Oil Co.* v. *FPC* 315 F.2d 652 (CA101963). In the *Permian* proceeding special allowances were made only for quality factors. 34 FPC 159, 221.

34. In the present proceeding we do not think that lack of price escalation is significant, for the price in any case is subject to the Southern Louisiana area price. Increased flexibility of operations might be significant, but here the record shows Texas Eastern is taking the gas at a normal rate and we shall require that it do so in the future. While these reserves are large and well located, this is not a unique feature in the lease-sale arrangement compared with many conventional contracts. These factors do not justify the price of gas to Texas Eastern under the contract which may be excessive even on the basis of the entire life of the field.[9] In view of this discussion it will not be necessary to consider directly the testimony referring to these factors, which was excluded by the Examiner, who was affirmed by us in our order of March 13, 1968 (39 FPC 268).

CONDITIONING THE LEASE-SALE FOR THE FUTURE

35. We agree with the Examiner's method of reducing the lease-sale transaction to conventional dimensions by

[9] The Commission's *Red Snapper* decision (*Tennessee Gas Pipeline Co.*, Docket Nos. CP65-365, *et al.*, Opinion Nos. 528 and 528-A issued Sept. 26, 1967 and Feb. 7, 1968, respectively, 38 FPC 691 and 39 FPC 149) is consistent with our determination herein. In both cases, the same in-line or area rate ceilings were imposed at the time of initial certification.

subtracting from the area price of 18.5 cents per Mcf effective October 1, 1968, those costs now borne by Texas Eastern that would normally be borne by the Producers and adding those economic advantages which would normally accrue to the Producers.

36. Under the lease-sale arrangement, Texas Eastern has paid royalties, based on 22.6 cents per Mcf, and state severance taxes of 2.3 cents per Mcf. In addition, it is required to bear the costs of developing the Rayne Field leases. The record indicates that for this purpose Texas Eastern has made capital expenditures that have not been reimbursed and will incur expenses for operating the field not reimbursed by liquid revenues.

37. Therefore, in order to equate this sale to the area price we shall require that the payments to be made by Texas Eastern for the Rayne Field gas until the purchase price of $134,395,700 has been paid be the equivalent of a purchase of gas under a conventional contract. To this end Texas Eastern shall pay the Producers 18.5 cents per Mcf for the gas produced from Rayne Field less royalties, state taxes and investments and expenses for the development and operation of the Field. The 18.5 cent price is, of course, subject to change in any future area proceeding. Under the lease-sale proposal before the termination of the production payments, that is when 613,406,770 Mcf has been produced, revenues from liquids produced from the Field are used to reimburse Texas Eastern for part of these investments and expenses, so that we shall provide that the 18.5 cent price should be reduced by only unreimbursed investments and expenses. After the end of the production payment until the entire purchase price is paid, the price should continue to be reduced by royalties, state taxes, investments and expenses, but should be increased by liquid revenues and salvage, for the Producers in a

conventional sale would receive the benefit of both these items.

38. Eventually, even though the payments are reduced, as long as gas continues to flow from the Rayne Field, Texas Eastern will pay the full purchase price of $134,395,700 albeit over a longer period of time.[10] In our opinion the Producers, providing there is sufficient gas, should receive the full amount for which they contracted even though they have been required to make a refund for the period prior to this order. After the full payment has been completed Texas Eastern will pay the Producers no more for gas taken from the Rayne Field. Since it will then have fully paid for the properties transferred, Texas Eastern, alone, should bear the cost of the royalties, state taxes and costs of operating the Field, but it should receive the benefit of all liquid revenues. Texas Eastern, however, should pay the Producers for any salvage realized on property installed before the purchase price has been fully paid, since the cost of such property under this opinion and order will be deducted from the price of gas of 18.5 cents per Mcf. Of course, salvage realized from property installed after the payments have been completed and not charged against the Producers should benefit Texas Eastern.

39. The conditions here outlined are based on the assumption that Texas Eastern will continue to take gas

[10] Commissioner Carver's dissent contends that by stretching out the period in which the $134,395,700 is to be paid to coincide with a take of the gas at the appropriate per Mcf price, we have given the producers less than this when the time value of the money is considered. This is, of course, correct but it does not follow either that we have thus effectively given the producers less than the per Mcf price for the gas we have found to be appropriate, or that use of the lease-sale price is inappropriate in our effort to protect the consumer while still affording the producers the other benefits of the lease-sale.

at a normal rate as it has been doing in the past. If it fails to do so, the time within which the Producers will receive the purchase price of $134,395,700 would be correspondingly extended to the detriment of the Producers, who would have no recourse against Texas Eastern in this respect. Therefore we shall provide that future takes be based upon a 20 year schedule for the removal of the gas and that Texas Eastern take gas at least at the rate of one 7300th of the reserves as estimated as of July 27, 1959 when the conveyance was made. The record shows that the residual gas available for the four party interest as of that time amounted to 974,067,000 Mcf at 15.025 psia. However, we shall permit that the one to 7300 level of takes be averaged over a yearly period and that daily takes be as low as 65 percent of the one to 7300 level. Furthermore, we shall permit suspension of takes in case of force majeure.

40. It will be observed that while we have substantially affected the payments made by Texas Eastern we have not amended the notes which Texas Eastern has given to the Producers. Since these appear to be negotiable instruments we think that any changes in the notes must be made by the parties or other holders.

41. With respect to the payment of royalties and costs associated with the development of the leases, the Producers are concerned that Texas Eastern might pay some unnecessary expenses. Texas Eastern is willing to give the Producers the right of prior approval before paying such expenditures. This should adequately protect the Producers' rights, and we shall so provide.

42. The Producers are also concerned that the effect of the Examiner's decision may be to include, as a deduction, the costs of the extraction plant owned and operated by LaGloria Oil and Gas Company, formerly a subsidiary of Texas Eastern. Under the processing contract, the Producers already bear the costs of the extraction plant. We do not believe the Examiner's decision placed a double burden on the Producers but, in order to resolve any ambiguity, we will clarify this point in our order.

43. The staff objects to the Examiner's adjustments on the ground that capital expenditures should be treated as rate base on Texas Eastern's books rather than a direct offset to the price for gas. The staff would reduce the price by the current costs of this rate base (including return, income tax, DD&A). Staff's position is consistent with normal accounting practice. Nevertheless, in view of the many difficulties described by Texas Eastern in following this suggestion, we shall adhere to the examiner's disposition, which achieves approximately the same result. Therefore additional capital expenditures will go to reduce the payments by Texas Eastern. Unamortized or undepreciated past capital expenditures will remain on Texas Eastern's books as provided below, but will not be included in Texas Eastern's rate base.

44. Finally, on the question of the propriety of the adjustments, the Producers object to the Examiner's provision adding to the payments for gas required of Texas Eastern the net salvage value realized by Texas Eastern upon retirement, through abandonment or removal, of Rayne Field facilities. Producers claim that they are entitled to all the salvage realized independent of payments made by Texas Eastern. We believe the Producers misconceive the intent of the Examiner's disposition of the net salvage. Salvage recoveries from Rayne Field would in fact be utilized to increase any installment payments for gas produced and delivered, but the amount of salvage

should not be counted towards payment of the purchase price. Since we have charged against the Producers the capital cost of facilities installed before the last installment of the purchase price is paid, in computing the amount of the installments to be paid by Texas Eastern, the Producers should properly receive all of the salvage realized from such facilities. We shall therefore require, as we believe the Examiner intended, that Texas Eastern make appropriate payments to the Producers during and after the period in which the purchase price is paid.

45. The Producers also object to the Examiner's failure in converting the lease-sale transaction to a conventional sale, to provide for periodic price increases, reimbursement for new taxes, take-or-pay, and the buyer's bearing cost of compression. In our opinion the staff and Texas Eastern are justified in arguing that if the Producers for their own purposes including possible tax advantages, entered into a lease-sale arrangement, they are not entitled to claim the benefit of provisions found in a conventional sale.

REFUNDS BY PRODUCERS

46. The parties have raised questions as to whether refunds by Producers are due for the period from 1959 to the effective date of the order. The Examiner found that taking all Texas Eastern's payments, including the downpayment and payments on the notes, together with royalties, state taxes and other costs normally borne by the Producers, Texas Eastern has paid more than the 20 cent per Mcf in-line price for the volumes received and the Producers therefore should refund the excess of $21,854,000 (through 1967) and interest of $9,595,000.

47. The Examiner adopts the computations made by the witness Bufkin for Texas Eastern. For the period 1959-

1967 witness Bufkin shows Texas Eastern's costs plus the downpayment and the note payments and subtracts from these what Texas Eastern would have paid at 20 cents per Mcf to obtain an overpayment of $21,853,700. Witness Frazier for PGW used the same figures but added $4,154 stated to represent Texas Eastern's Federal income tax attributed to the Rayne Field transaction, but the Examiner rejected this additional amount.

48. In our opinion the general approach used by the Examiner is reasonable. It is undeniable that the payments made by Texas Eastern in the 1959-1967 period represent more on an Mcf basis than the in-line price of 20 cents. Even though, if the reserve estimates are correct, Texas Eastern under the conditions we are prescribing will eventually pay the full contract amount in payments for future volumes of gas, there are too many unknown factors to justify us permitting the burden of the high early payments to remain on the consumers. In accordance with our prior discussion the bases of the refund should be 20 cents per Mcf up to October 1, 1968, when the Southern Louisiana area decision became effective, and from then on 18.5 cents to the date of refund.

49. PGW objects to the Examiner excluding from the Producer refund the $4,154,260 in additional income taxes that Texas Eastern has had to pay as a result of the lease-sale transaction. It contends that although it will be reimbursed fully if the Examiner's entire refund is flowed-through to Texas Eastern's customers, it might fail to recover the full amount of excess charges if the tax item is not included and if the Commission does not order a complete flow-through. It appears to us that the Examiner is correct in holding that the extent to which a particular form of sale affects the buyer's earnings is merely inci-

dental and is not the basis on which refunds are determined. Furthermore, the calculation of taxes was purely theoretical, not founded on Texas Eastern's actual earnings or taxes and did not take into account possible carry-backs or carry-forwards in case Texas Eastern was required to make refunds.

50. The Producers say the Examiner erred in allowing Texas Eastern royalties on the basis of a market value of 22.6 cents per Mcf, which is above the in-line price in the area. They consider that Texas Eastern made an error of judgment, which should be charged against it, not the sellers. Texas Eastern shows however, that, in view of the law of Louisiana giving a royalty owner a claim against a leaseholder if he does not feel he is getting a fair price for the royalty gas, it sought permission from the Producers to reduce the royalty payment, but could not obtain it. It should be recalled that for the future Texas Eastern is willing to give the Producers the right of prior approval of its royalty payments, and we so provide.

51. The Examiner calculated interest at 6 percent to March 1, 1960 and 7 percent thereafter in accordance with Commission Order No. 215-A, 23 FPC 474, and subsequent Commission precedents. As noted above interest on this basis would amount to $9,595,000 by the end of 1967. After April 30, 1968, the Examiner would compound the interest monthly following the lead of the Commission's Order No. 362, issued April 2, 1968, 39 FPC 412, although that order does not in terms apply to Section 7 proceedings.

52. The Producers argue that interest is a matter of discretion and that they have not knowingly made excess charges. Furthermore, at least until the Supreme Court's decision on June 1, 1965, they say they did not know that the sale was jurisdictional. Interest, however, is compensation for the use of capital. If it is determined that a refund is due, the Producers have had the use of funds, and interest on them, to which they were not entitled. Interest, therefore, should be charged and compounded in accordance with the policy of Order No. 362 after April 30, 1968. However, in *Texaco Inc.* v. *F.P.C.*, ... F.2d ...... (CA3, 1969) the promulgation of Order No. 362 was found faulty so that interest due to compounding is subject to further rulemaking proceedings on the matter of compound interest.

53. The Producers also object to making a lump sum payment, which they say would penalize them without providing consumers any benefits. They would rather have the refund take the form of reductions in future payments by Texas Eastern. In our opinion under the circumstances here where Texas Eastern has been required to make large payments in excess of the in-line price in accordance with a unique contract an immediate refund would be preferable to put all parties as closely as possible in the position they would be under a conventional sale. Furthermore, refunds extended over future periods would not be the financial equivalent of a lump sum payment unless additional interest charges were added.

FLOW-THROUGH OF REFUNDS

54. The Examiner ordered that the Producers pay the required refunds to Texas Eastern and Texas Eastern deposit them in a special escrow account subject to disposition by the Commission in a further proceeding. The Examiner considered that Opinion Nos. 540 and 540-A, *Texas Eastern Transmission Corp.*, Docket No. RP66-12, were controlling.[11] There the Commission required Texas

[11] 39 FPC 630; 40 FPC 62; affirmed *Texas Eastern Transmission Corp.* v. *F.P.C.*, ... F.2d ...... (CA5, 1969).

Eastern to flow-through Producer refunds related to the years 1962-1964. The Commission noted that the Examiner's conclusion that Texas Eastern had in fact earned more than a reasonable rate of return during the years in question was supported by the record and emphasized the right of a pipeline to file tracking rate increases when its costs increase.

55. We think the present case is distinguishable. There is no supplier rate increase involved here, the annual expense of which Texas Eastern could have passed on to its customers through a rate increase filing, had it believed the rate increase could be justified. Instead, under the lease-sale (which will remain in existence, though gas payments therefrom are conventionalized), the down payment, note payments and most of the other capital expenditures were reasonably treated by Texas Eastern as a capital investment, and as such in any rate case Texas Eastern could not have recovered anything more than the approved rate of annual return on such expenditures, depreciation, depletion and amortization, and certain expenses and taxes. In view of this situation we should not prescribe a complete flow-through by Texas Eastern of the refunds from the Producers.

56. However, it is clear that Texas Eastern could have filed rates including Rayne Field costs on the above basis for the entire refund period. In fact, on May 28, 1959, it filed rate increases in Docket No. G-18841, which was settled, effective December 1, 1959, on the basis of computations that did include Rayne Field costs (see 25 FPC 172 and settlement agreement). These rates remained in effect until January 1, 1964, when a voluntary rate reduction filed by Texas Eastern in Docket No. RP64-36 to reflect the decrease in the corporate income tax rate became effective.

Texas Eastern's rates were next changed effective June 1, 1965, as a result of conferences with the Commission staff in Docket No. RP65-59, and Rayne Field costs were again included.[12]

57. This leaves the period from the beginning of operations on July 27, 1959 to December 1, 1959. During this period there were effective settlement rates in Docket No. G-12706 arising from a filing made on May 10, 1957, but they were not supported by Rayne Field costs. However, as developed below it is possible to estimate the Rayne costs that could have been charged to Texas Eastern's customers in a rate filing covering this period.

58. A complete flow-through of the producer refund would put Texas Eastern in the position of paying too much for part of the Rayne Field gas without any relief and then paying the just and reasonable price for additional gas until the Producers shall have received the full purchase price of $134,395,700, so that Texas Eastern would end up paying some $21,000,000 more than it had originally contracted to pay. However, to the extent the excessive payments in the years from 1959 to the present have fallen on its customers, Texas Eastern has already been reimbursed and the customers should receive a flow-through refund of that amount.

59. The record contains data on the amount of Rayne costs that have been imposed on Texas Eastern's customers. Texas Eastern's witness Bufkin and PGW witness Frazier made computations on the basis of the costs of the Rayne

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[12] The original settlement agreement provided for the flow-through of Producer refunds (see 34 FPC at p. 100), but by later order the flow-through language was deleted and it was provided that no party would waive any right, claim or argument with respect to Rayne Field (34 FPC 732).

gas to Texas Eastern. Both witnesses covered a period from 1959 through 1967. As so computed Mr. Bufkin found costs in excess of 20 cents per Mcf in the amount of $10,133,000 and Frazier $13,338,008.

60. On the other hand staff witness Werner for the period 1959-1966 found costs in excess of 20 cents to amount to $15,422,532. Mr. Werner based his computation on the costs used to compute Texas Eastern's successive settlement rates in Docket Nos. G-18841, RP64-36, and RP65-59, and as such we think that his approach more accurately reflects Rayne Field costs paid by Texas Eastern's customers than the presentations of Frazier and Bufkin. Texas Eastern, however, alleges several errors in Mr. Werner's computation.

61. In the first place Texas Eastern points out that Mr. Werner has calculated a unit cost of Rayne Field gas for each of the rate periods covered using estimated volumes for a limited time period and then has applied the unit cost to the substantially larger volumes that were actually delivered. Texas Eastern argues that Mr. Werner's calculation results in a substantially higher cost for Rayne Field gas because the amount of fixed cost (largely return and taxes) is improperly increased by using larger volumes. This is not a valid criticism, for Mr. Werner based his computations on the Rayne Field costs used in reaching the settlement rates. When the unit costs were applied to larger volumes during the full period the rates were in effect, the customers were properly found to have paid additional amounts of Rayne Field cost, including fixed costs.

62. For the Docket No. RP65-69 period[13] Texas Eastern objects to Mr. Werner's use as working capital of the stipulated gross balance ($8,578,662) in Texas Eastern's Miscellaneous Deferred Debits Account (MDD) without reducing it for income tax accruals. Such a reduction is, of course, an ordinary and usual element in the computation of a rate base for cost of service purposes. Texas Eastern's witness Bufkin determined a company-wide ratio of accrued Federal income taxes to working capital to be 31.6 percent and applied this same percentage to the $8,578,662 gross amount of MDD attributable to Rayne Field, resulting in a net amount of $5,871,236, which he included in the Rayne Field rate base as working capital.

[13] MDD was not involved in Texas Eastern's rates under the earlier settlement dockets.

63. In determining company-wide costs the company-wide working capital might properly be reduced by 31.6 percent, but a distortion results when the Rayne Field working capital, which is very large compared with the rest of the Rayne Field investment, is reduced by the same percentage. Rather a tax based on Rayne Field revenues should be applied to the Rayne Field working capital. If this calculation were made, the Rayne Field working capital would be reduced by only 2.75 percent.

64. Thirdly, Texas Eastern objects that in computing Federal income taxes applicable to the return on Rayne Field investments, Mr. Werner did not use an interest deduction. Primarily, Mr. Werner felt that this was an undue refinement; but he was also influenced by the fact that Texas Eastern's notes are non-interest bearing. In our opinion any investment depends upon the entire credit of the company including interest bearing securities outstanding. Therefore, in computing Federal income taxes an interest deduction should be made.

65. As revised in accordance with this discussion and updated through 1967, Mr. Werner's computation would

show Rayne Field costs paid by Texas Eastern's customers as follows (See Appendix B):

Docket No.	Period	Unit Cost	Charge in excess of 20¢ per Mcf
G-18841	12-1-59 — 12-31-63	23.56	$ 6,618,610
RP64-36	1-1-64 — 5-31-65	23.46	2,326,469
RP65-59	6-1-65 — 12-31-67	23.68	4,472,046
			$13,417,125

66. For the short period from the beginning of operations on July 27, 1959 until December 1, 1959, when the settlement rates in Docket No. G-12706 were in effect, Texas Eastern might have filed rates reflecting Rayne Field costs assuming that the settlement rates did not, in effect, cover these costs. The costs would have been approximately the same as those employed in Docket No. G-18841 except that the rate base would not have been reduced by DD&A (see Appendix C).[14] As so computed the unit cost would have been 23.62 cents and the additional costs borne by Texas Eastern's customers would have been $431,794. This amount should be added to the $13,417,125 charge in excess of 20 cents borne by Texas Eastern's customers, which will now become $13,848,919.

67. Up until the end of 1967 an allocated part of the interest would amount to $6,080,371 or a total refund to that date of $19,929,290. This figure must, of course, be brought up-to-date on the basis of 20 cents to October 1, 1968, and 18.5 cents thereafter, with additional interest. We shall require that Texas Eastern make such a calculation in accordance with this opinion subject to our approval. In view of the lack of information in the record

[14] For these calculations a 6¼ percent rate of return was used.

as to the entitlement to the refunds and the questions that may arise, we shall require that Texas Eastern hold the amounts to be flowed-through subject to our further order. Compare *Texas Eastern Transmission* v. *F.P.C., supra.*

ACCOUNTING ADJUSTMENTS REQUIRED

68. As of December 31, 1967, Texas Eastern's books showed a net investment in the Rayne Field of $20,822,996. This represents $7,835,012, which is the net of plant and depreciation reserve accounts, and $12,987,984 in Miscellaneous Deferred Debits. In addition, Texas Eastern seeks to be reimbursed out of refunds it may receive for previously unrecovered and uncapitalized expenditures in the amount of $3,040,821. Upon receiving the refunds Texas Eastern proposes to eliminate the total capital investment of $20,822,996 by debiting cash and crediting the capital investment, but the Examiner ordered the entire amount written off against surplus.

69. As provided above, $13,848,919 of the refund plus $6,080,371, a proportional part of the interest, or a total of $19,929,290, and additional amounts to bring it up to date will be flowed through to Texas Eastern's customers to reimburse them for a burden actually borne by them. The remainder of refund in the amount of $8,005,081 plus the remainder of the interest of $3,514,629 or $11,519,710 should be used to reduce the balance on Texas Eastern's books, leaving $9,303,286. The additional $3,040,821 results principally from the facts that amounts expended in connection with the Rayne Field were not included among the costs underlying Texas Eastern's rates prior to December 1, 1959, when the settlement rates in Docket No. G-18841 became effective, 25 FPC 172. It seems clear that Texas Eastern cannot now claim costs that were not covered by rates filed on May 10, 1957, in Docket No. G-12706, effec-

tive as its filed rates until December 1, 1959, and eventually covered by the settlement of January 25, 1961 (25 FPC 172).

70. The balance of $9,303,286, brought up-to-date, may remain on Texas Eastern's books if the company desires, but it shall be recorded in other than "rate base" accounts. In some ways this represents a prepayment for gas, and we have allowed pipelines to earn a return on prepayments. See *Michigan Wisconsin Pipe Line Company*, 27 FPC 449, 455 (1962), cited by Texas Eastern, and 36 FPC 176, 216 (1966). However, prepayments ordinarily occur where the pipeline under a conventional contract has taken less than the required quantity of gas. Here we have an uncommon situation involving large payments, as part of the basic transaction calling for such payments in the early years of the contract. We think, therefore, that the cost of Rayne gas which will be reflected in future rates to Texas Eastern's customers should not be increased above the 18.5 cent just and reasonable level by permitting Texas Eastern to add the Rayne Field balances to its rate base and earn a return on them.

71. However, we do not think Texas Eastern should be penalized for entering into this transaction if it can be made whole without loss to its customers. Therefore it may compute a return on the Rayne Field balances and accumulate it each year. As already discussed, Texas Eastern on the basis of the 18.5 cent price per Mcf shall complete paying the full purchase price of $134,395,700, including the return to the Producers of the refunds they have made ($21,854,000 brought up-to-date). At that point, provided the Field is still productive, we shall require that Texas Eastern use the difference between what it then must pay for gas (royalties, taxes, and other costs less credits) and what it would have to pay under the applicable area price

to amortize the balance. Texas Eastern will incur the risk that there will not be enough gas from the field to enable it to completely amortize the balance, but this is a consequence of the lease-sale type of contract. It may be protected, in part, by the Producers' reserve guarantee, if the certificate issued by us is satisfactory to the Producers.

72. Texas Eastern argues that the Rayne Field balances are properly includible in its rate base, and that this was recognized in the settlement of Docket No. G-18841 effective December 1, 1959, and in Docket No. RP65-59 effective June 1, 1965. The settlement orders in no way inhibit the Commission in its treatment of the Rayne Field balances. The order in Docket No. G-18841, dated January 25, 1961, 25 FPC 172, related to the rates filed therein and was, in the usual boiler plate, "without prejudice to any claims or contentions . . . in any proceeding now pending or hereafter instituted . . ." The order in RP65-59 of July 21, 1965, 34 FPC 98, 101, specifically provides that the inclusion of the Rayne Field costs shall not limit the rights of the Commission in the present Docket No. G-12446.

RATE REDUCTION BY TEXAS EASTERN

73. In accordance with the Commission's order of February 23, 1968, the Examiner considered the question whether Texas Eastern's rates should be reduced as a result of his reducing the Producer rates in Phase I to 20 cents per Mcf as adjusted (subject to the now applicable further reduction to 18.5 cents per Mcf prescribed in AR-61-2). He concluded that the commodity charge in Texas Eastern's systemwide rates should be reduced by 0.2 cents per Mcf. The authority of the Commission to make such a reduction and its amount are contested by Texas Eastern.

74. Texas Eastern argues that under Section 7 of the

Act the Commission has no authority to revise systemwide rates it previously found to be just and reasonable. Whatever our authority to enter into a rate proceeding under Section 7 or whatever the public interest may be in doing so (see *Florida Gas Transmission Co.,* 37 FPC 424, 444 (1967)), that question need not arise here, for Texas Eastern on October 30, 1968, filed a rate increase under Section 4(e) of the Act that includes as a basis the Rayne Field costs. The increase was suspended for five months until May 15, 1969, in Docket No. RP69-13 and is in hearing before a presiding examiner. We think, however, that our opinion here may properly provide the basis for interim action in Docket No. RP69-13. Just as in *Natural Gas Pipeline Company,* 38 FPC 1136, Opinion No. 535, we ordered Natural to reduce its filed rate as of the date it went into effect and before completion of the proceedings, so in the present case we shall order Texas Eastern to file substitute rates to reflect any reduction in costs arising from these proceedings and in accordance with this opinion (see also *F.P.C. v. Tennessee Gas Transmission Co.,* 371 U.S. 145 (1962)).

75. As long as Texas Eastern is paying the producers for the gas and until the purchase price of $134,395,700 has been paid, and from then until complete amortization of the Rayne Field balances on Texas Eastern's books, Texas Eastern's rates should continue to reflect the cost of the Rayne Field gas at the applicable area rate, now 18.5 cents per Mcf. However, when the amortization of the Rayne Field balances has been completed, Texas Eastern, providing that it is still selling gas from Rayne Field, should file new rates to reflect the fact that it is no longer paying the producers but is merely paying royalties and other expenses.

CONCLUSION

76. We have provided here for continuation of the lease-sale arrangement, but so modified as to make it equivalent, until the purchase price of $134,395,700 is paid, to a sale at the price of 18.5 cents per Mcf, which we have determined to be just and reasonable in the *Southern Louisiana Area Proceeding,* AR61-2.

77. We are ordering refunds from the commencement of operations based upon the in-line price of 20 cents until October 1, 1968, and 18.5 cents thereafter and shall provide for the flow-through of the refunds to Texas Eastern's customers to the extent they have borne the financial burden of the lease-sale transaction. Texas Eastern shall reduce the Rayne Field debit balances on its books by the portion of the refund and interest it is permitted to retain and transfer the remaining balances to a special subdivision of Account 124. It shall not be permitted to include the remaining balances in its rate base, but may hold them and augment them with an amount equivalent to return each year. When payment of the purchase price has been completed, if there is sufficient gas remaining, it shall amortize these balances *and include such amortization among costs chargeable to its customers.*

78. Texas Eastern shall reduce its claimed rate increase in its current rate proceeding, Docket No. RP69-13 to reflect the opinion and order, and shall further reduce its rates after the purchase price has been paid and its Rayne Field investment balances have been amortized, so as to reflect only the costs of operating the Rayne Field at that time. We are of the opinion that if Rayne Field has enough gas in it to reach this stage, the benefit should go to consumers, for the Producers will have received full payment of the purchase price and Texas Eastern will

have been made whole after having paid costs in excess of the in-line and just and reasonable price. In any case it is our intention, and our opinion and order is so designed, that the customers of Texas Eastern will pay no more than rates based upon a purchase gas cost for Texas Eastern of the in-line price of 20 cents per Mcf from the commencement of operations until October 1, 1968, the effective date of the *Southern Louisiana* rate proceeding, and from then on no more than 18.5 cents per Mcf which we have found to be the just and reasonable rate for gas of this vintage, or no more than any future area rate level determined by us.

79. It may be, however, that instead of operating under the lease-sale as conditioned by this opinion and order, Texas Eastern would prefer to rescind the arrangement and purchase gas under a conventional sale. We shall permit it to do so, but this, of course, would require transfer of property and financial adjustments in addition to a refund by the Producers.

The Commission further finds:

(1) Texas Eastern Transmission Corporation, a Delaware corporation having its principal place of business in Houston, Texas, is a "natural-gas company" within the meaning of the Natural Gas Act, as heretofore found by the Commission.

(2) Continental, Sun, Marr and General Crude are natural-gas companies within the meaning of the Natural Gas Act.

(3) The sales and transportation of natural gas hereinbefore described, as more fully described in the respective applications are made in interstate commerce, subject to the jurisdiction of the Commission and such sales and trans-

portation, together with the construction and operation of any facilities subject to the jurisdiction of the Commission necessary therefor, are subject to the requirements of Subsections (c) and (e) of Section 7 of the Natural Gas Act.

(4) The respective Applicants are able and willing properly to do the acts and to perform the services proposed and to conform to the provisions of the Natural Gas Act and the requirements, rules and regulations of the Commission thereunder.

(5) The sales of natural gas by Continental, Sun, Marr and General Crude, and the transportation and sale of natural gas by Texas Eastern, together with the construction and operation of any facilities subject to the jurisdiction of the Commission necessary therefor, are required by the public convenience and necessity and certificates therefor should be issued as hereinafter orderd and conditioned.

The Commission orders:

(A) Certificates of public convenience and necessity are issued authorizing Applicants Continental, Sun, Marr and General Crude to sell natural gas in interstate commerce for resale, Texas Eastern to transport and sell natural gas in interstate commerce for resale and the Applicants to construct and operate the facilities subject to the jurisdiction of the Commission necessary therefor as described above or in their applications, upon the terms and conditions of this order.

(B) The certificates issued by paragraph (A) above and the rights granted therein are conditioned upon Applicants' compliance with all applicable Commission Regulations under the Natural Gas Act and, for Texas Eastern,

the general terms and conditions set forth in paragraphs (a), (e), (f) and (g) of Section 157.20 of such Regulations.

(C) The certificates issued to Continental, Sun, Marr and General Crude and to Texas Eastern shall be subject to the following conditions:

(1) From and after 90 days from the date of this order, and until Texas Eastern has paid the entire purchase price of $134,395,700 in addition to amounts ordered to be refunded by the Producers, no payment subject to the provisions below shall exceed 18.5 cents per Mcf of natural gas at 15.025 psia (or other applicable area prices determined by this Commission) produced from the entire property that is the subject of the applications, including royalty gas, during the period beginning thirty days prior to the previous installment and ending thirty days prior to the current installment, less the following liabilities paid or incurred by Texas Eastern during that period in connection with Rayne Field or its products:

(a) Royalties, but from the date of this order no royalties shall be paid until they are approved by Continental for the Producers;

(b) State taxes;

(c) Any investment or expenses incurred for the development or operation of the field or the gathering, movement or treatment of gas or liquids derived therefrom (excepting the operations of LaGloria Oil and Gas Co.) other than transportation of the gas through and beyond the construction by Texas Eastern herein applied for and certificated, except to the extent that such investments and expenses are reimbursed to Texas Eastern under the terms of the agreements between the producer-applicants and Texas Eastern relating to the applications, but from the date of this order no expenses or costs shall be incurred by Texas Eastern in the

Rayne Field until they are approved by Continental for the Producers plus the following items:

(d) Net receipts of Texas Eastern from the sale of liquids after completion of the production payments;

(e) Any salvage realized by Texas Eastern from any investments made before completion of payment of the purchase price; the Producers shall receive payment or credit under this item in the years in which the related physical assets are retired.

(2) The above limitations shall be cumulative, that is, in calculating the amount payable at the time of any installment, the payments and offsets in the foregoing paragraph shall be totalled from the effective date of this order and matched against all previous installments from that date, to the extent paid hereunder, to determine the amount payable on any current installment.

Texas Eastern shall continue payments in accordance with this paragraph (2) until the Producers have received the entire purchase price of $134,395,700, including amounts necessary to compensate the Producers for the amount of the purchase price refunded for the period from 1959 to the date of this order, but salvage on property installed before payment of the full purchase price shall not be counted towards the purchase price.

(3) After the Producers have received the full purchase price Texas Eastern shall not be required to make further payments for gas but shall pay the Producers salvage realized from investments made before this time, and shall meet all expenses and capital costs of operating Rayne Field.

(4) Future takes of gas by Texas Eastern from the Rayne Field reserves shall be at least at the average daily level of no less than one 7300th of the reserves estimated as of the time of the conveyance on July 27, 1959. This quantity which shall be averaged over a

period of one year, may on a given day be as low as 65 percent of the one to 7300 level of takes.

In the event Texas Eastern is rendered unable, wholly or in part, by force majeure to carry out this provision on its giving notice and full particulars of such force majeure, in writing or by telegraph, to the Producers as soon as possible after the occurrence of the cause relied on, then its obligations so far as they are affected by such force majeure, shall be suspended during the continuance of any inability so caused, but for no longer period; and such cause shall as far as possible be remedied with all reasonable dispatch.

(5) Within 30 days the Producers shall file with this Commission rate schedules, subject to the approval of the Commission effective 90 days from the date of this order which are applicable to the sales herein authorized and which are not inconsistent with this decision, and shall serve a copy on each party to this proceeding who has 20 days within which to submit comments thereon.

(6) Within 150 days from the date of issuance of this order Producers shall file a computation of refund subject to the approval of the Commission and shall serve a copy on each party to this proceeding who has 20 days within which to submit comments thereon. The computation shall cover the period from January 1, 1968, until 90 days after the issuance of this order. The refund shall represent the amounts received by the Producers plus costs incurred by Texas Eastern in connection with the Rayne Field less 20 cents per Mcf for gas delivered to Texas Eastern until October 1, 1968, and 18.5 cents thereafter computed in accordance with this opinion and order. Interest shall be computed at 7 percent per annum up to April 30, 1968, and thereafter shall be compounded monthly subject to the outcome of further proceedings regarding Docket No. R-340. See *Texaco, Inc.* v. *F.P.C.*, ... F.2d ......, (CA3, Nos. 17379 and 17540, June 12, 1969).

(7) Within 150 days from the date of issuance of this order Texas Eastern shall file a computation of the

excess Rayne Field costs borne by its customers subject to the approval of the Commission and shall serve a copy on each party to the proceeding who has 20 days within which to submit comments thereon. The computation shall cover the period from January 1, 1968, until 90 days after the issuance of this order and shall be carried out in accordance with this opinion using a cost basis of 20 cents per Mcf until October 1, 1968, and 18.5 cents per Mcf thereafter.

(8) Within 30 days of the Commission's approval of the computations required in (6) above, the Producers shall make refund to Texas Eastern of $21,854,000 plus the amounts referred to in (6) above together with interest to the date of payment computed in accordance with this order.

(9) Within 30 days of the refund required in (8) above Texas Eastern shall report the amounts refundable to each of its customers, comprising the amount of $13,848,919 plus the amounts computed in (7) above as representing excess costs borne by its customers plus an allocable part of the interest refunded by the Producers and shall retain an amount of money equal to that shown in the report subject to further order of the Commission directing the disposition of the amount. If Texas Eastern elects to commingle the retained refund with its general assets and use it for its corporate purposes, it shall pay interest thereon at the prime rate of interest in effect on the date of filing the report on the amount available from the date of the filing of the report to the date on which the refund is paid over to the persons ultimately determined to be entitled thereto in a final order of the Commission. If Texas Eastern elects to deposit the retained refund in a special escrow account, it shall tender for filing on or before the date of the filing of the refund report an executed Escrow Agreement, conditioned as set forth below. Unless notified to the contrary by the Secretary within 30 days from the date of filing thereof, the Escrow Agreement shall be entered into between Texas Eastern

and any bank or trust company used as a depositor for funds of the United States Government and the agreement shall be conditioned as follows:

The conditions of the Escrow Agreement to be executed by Texas Eastern Transmission Corporation:

(a) Texas Eastern, the bank or trust company, and the successors and assigns of each, shall be held and formally bound unto the Federal Power Commission for the use and benefit of those entitled thereto, with respect to all amounts and the interest thereon deposited in a special escrow account, subject to such Agreement, and such bank or trust company shall be bound to pay over to such person or persons as may be identified and designated by final order of the Commission and in such manner as may be therein specified, all or any portion of such deposits and the interest thereon.

(b) The bank or trust company may invest and reinvest such deposits in any short-term indebtedness of the United States or an agency thereof or in any form of obligation guaranteed by the United States which is, respectively, payable within 120 days as the said bank or trust company in the exercise of its sound discretion may select.

(c) Such bank or trust company shall be liable only for such interest as the invested funds described in paragraph (2) above will earn and no other interest may be collected from it.

(d) Such bank or trust company shall be entitled to such compensation as is fair, reasonable and customary for its services as such, which compensation shall be paid out of the escrow account to such bank or trust company. Said bank or trust company shall likewise be entitled to reimbursement for its reasonable expenses necessarily incurred in the administration of this escrow account, which reimbursement shall be made out of the escrow account.

(e) Such bank or trust company shall report to the Secretary of this Commission quarterly, certifying the amount deposited in the trust account for the quarterly period.

(10) Texas Eastern shall record in a special subdivision of Account 124, Other Investments, the net investments in the Rayne Field. This shall include a debit for the cost of plant now in Account 101, Gas Plant in Service, and a credit for the related amounts in Account 108, Accumulated Provision for Depreciation of Gas Plant in Service, and a transfer of the accumulation of the amounts now recorded in Account 186, Miscellaneous Deferred Debits. Texas Eastern shall credit the special subdivision of Account 124 with the balance of the principal and interest refunded by the producers in accordance with (8) above, after deducting that portion refunded by Texas Eastern to its customers in accordance with (9) above. Thereafter Texas Eastern will not be allowed to depreciate any amounts related to any plant items includible in the special subdivision of Account 124. If any of the plant items includible in the special subdivision of Account 124 are depreciable for tax purposes, the amount of the reduction in taxes shall be credited thereto. When the entire original contracted for purchase price shall have been paid to Producers, Texas Eastern shall annually credit the Rayne Field investment account with the difference between what it then must pay for gas (royalties, taxes and other costs, less credits for liquids and salvage on property installed after completion of the purchase price) and what it would have to pay for gas under the applicable area price, and charge that difference to operating expenses. The balance in the special subdivision of Account 124, representing the Rayne Field investment for the purpose of the preceding sentence shall be allowed to accumulate on an annually compounded basis an amount equal to Texas Eastern's allowed rate of return. The detailed accounting for such allowance shall be coordinated with this Commission's Chief Accountant and approved by this Commission.

(11) Upon complete amortization of the Rayne Field investment balances in accordance with (10) above if gas is still being produced from the Rayne Field Texas Eastern shall file reduced rates, subject to the approval of the Commission, to reflect the costs of operating the Rayne Field at that time.

(12) Texas Eastern shall amend its rate filing in Docket No. RP69-13 or other rates in effect as of the date the Producers start charging the reduced rates required to be filed by paragraph (5) or (13) of this order to reflect its Rayne Field cost of gas as determined in accordance with this opinion and order.

(13) If Texas Eastern desires not to accept the modified lease-sale arrangement here provided, it shall notify the Commission and the Producers within 30 days of the issuance of this opinion and order. Within 90 days the Producers shall file rate schedules, subject to the Commission's approval for the sale of gas from the Rayne Field to Texas Eastern at 18.5 cents per Mcf under conventional terms. All parties at the same time shall file appropriate documents rescinding the lease-sale arrangement. When Texas Eastern files the notice referred to here, conditions (1)-(5), (10) and (11) shall be stricken. When Texas Eastern receives the refund provided in (8), it shall use the portion retained to credit the Rayne Field balance and shall write off the remainder of such balance.

(D) The decisions of the Presiding Examiner on January 23, 1968, and September 11, 1968, are adopted as the decision of the Commission to the extent not inconsistent herewith.

(E) Exceptions not granted are denied.

By the Commission.
(SEAL)

Chairman White dissenting in part filed a separate statement appended hereto. Commissioner Carver dissenting filed a separate statement appended hereto, Commissioner Brooke joins in the dissent.

Kenneth F. Plumb,
Acting Secretary.

This opinion was adopted before Chairman White left the Commission.

Appendix A
Sheet 1 of 2

COST TO TEXAS EASTERN TRANSMISSION CORPORATION OF RAYNE FIELD GAS UNDER LEASE SALE ARRANGEMENT DISCOUNTED TO 1959 VALUE

Year	Costs				Credits			
	Note Payments	Royalty Payments	Severance Tax	Unreimbursed Capital Exp.	Salvage and Liquid Rev.	Net Cost to TETCO	Discount Factor @ 5% Rate	Discounted Value as of 1959
1959	13,992	603	294	130	—	15,019		15,019
1960	6,284	1,650	796	847	—	9,577	.95238	9,121
1961	6,714	1,654	804	—	—	9,172	.90703	8,319
1962	8,005	1,847	896	—	—	10,748	.86384	9,285
1963	8,006	2,009	968	—	—	10,983	.82270	9,036
1964	8,005	1,883	906	—	—	10,794	.78353	8,457
1965	8,006	1,861	894	—	—	10,761	.74622	8,030
1966	8,005	1,768	853	—	—	10,626	.71068	7,552
1967	8,005	1,741	921	—	—	10,667	.67684	7,220
1968	8,005	1,704*	921	—	—	10,630	.64461	6,852
1969	8,006	1,560	921	—	—	10,487	.61391	6,438
1970	8,005	1,560	920	679	—	11,164	.58468	6,527
1971	8,006	1,560	921	339	—	10,826	.55684	6,028
1972	8,005	1,560	921	340	—	10,826	.53032	5,741
1973	8,006	1,561	921	—	—	10,488	.50507	5,297
1974	8,005	1,547	913	—	—	10,465	.48102	5,034
1975	3,336	1,416	836	—	2,974	2,614	.45811	1,197
1976	—	1,257	742	291	3,865	(1,575)	.43629	(687)
1977	—	1,108	654	—	3,186	(1,424)	.41552	(592)
1978	—	1,003	592	—	3,072	(1,477)	.39573	(584)
1979	—	912	538	—	2,518	(1,068)	.37689	(403)
1980	—	732	432	—	2,113	(949)	.35894	(341)
1981	—	411	242	—	965	(312)	.34185	(107)
1982	—	361	213	—	533	41	.32557	13
1983	—	317	187	—	452	52	.31007	16
1984	—	276	163	—	486	(47)	.29530	(14)
1985	—	207	122	—	357	(28)	.28124	(8)
1986	—	22	13	—	195	(160)	.26785	(43)
TOTAL	$134,396	$34,090	$18,504	$2,626	$20,716	$168,900	.....	$122,403

* For comparison purposes the royalty payments were adjusted effective October 1, 1968 and thereafter to reflect the 18.5 cents per Mcf price prescribed by the Commission's *Southern Louisiana* Opinions Nos. 546 and 546-A.

Appendix A
Sheet 2 of 2

TEXAS EASTERN TRANSMISSION CORPORATION, et al DOCKET No. G-12446, et al.

Estimated Cost Under Conventional Transaction as Discounted to 1959

Year	Volumes (Mcf)	Price (¢/Mcf)	Cost ($)	5% Discount Factor	Cost Discounted To 1959 Value
1959	15,473	20.0	3,095		3,095
1960	41,917	20.0	8,383	.95238	7,984
1961	42,288	20.0	8,458	.90703	7,672
1962	47,133	20.0	9,427	.86384	8,143
1963	50,957	20.0	10,191	.82270	8,343
1964	47,739	20.0	9,548	.78353	7,481
1965	47,100	20.0	9,420	.74622	7,029
1966	44,918	20.0	8,984	.71068	6,385
1967	48,505	20.0	9,700	.67684	6,565
1968	48,458	*	9,509	.64461	6,130
1969	48,467	18.5	8,966	.61391	5,504
1970	48,452	18.5	8,964	.58468	5,241
1971	48,456	18.5	8,964	.55684	4,992
1972	48,457	18.5	8,965	.53032	4,754
1973	48,469	18.5	8,967	.50507	4,529
1974	48,062	18.5	8,891	.48102	4,277
1975	43,987	18.5	8,138	.45811	3,728
1976	39,031	18.5	7,221	.43629	3,150
1977	34,428	18.5	6,369	.41552	2,646
1978	31,163	18.5	5,765	.39573	2,281
1979	28,344	18.5	5,244	.37689	1,976
1980	22,736	18.5	4,206	.35894	1,510
1981	12,764	18.5	2,361	.34185	807
1982	11,210	18.5	2,074	.32557	675
1983	9,856	18.5	1,823	.31007	565
1984	8,576	18.5	1,587	.29530	469
1985	6,430	18.5	1,190	.28124	335
1986	689	18.5	127	.26785	34
TOTAL	974,067		$186,537		$116,270

* Price changed from 20.0¢/Mcf to 18.5¢/Mcf effective October 1, 1968, in accordance with Commission Opinion No. 546-A, issued March 20, 1969.

Appendix B

Sheet 1 of 5

TEXAS EASTERN TRANSMISSION CORPORATION, et al.

Docket No. G-12446, et al.

Texas Eastern Overcollections From Gas Service Customers Based Upon Collection in Rates of Rayne Gas Cost Exceeding 20¢/Mcf

December 1, 1959 Through December 31, 1967

Exhibit 24 Recalculated

Line No.	Docket No. (a)	Rate Period From (b)	Rate Period To (c)	Unit Cost ¢/Mcf (d)	Source Reference (e)	Rayne Gas Production Applicable to Conoco et al. MMCF (15.025 #) (f)	Total Cost of Rayne Gas Charged Customers (Col. d x Col. f) (g)	Cost of Rayne Gas at 20¢/Mcf (Col. f x 20¢) (h)	Overcharges by Texas Eastern to be Refunded (i)
1.	G-18841	12-1-59	12-31-63	23.56	Sheet 2	185,916	$43,801,810	$37,183,200	$ 6,618,610
2.	RP64-36	1-1-64	5-31-65	23.46	Sheet 3	67,239	15,774,269	13,447,800	2,326,469
3.	RP65-59	6-1-65	12-31-67	23.68	Sheet 4	121,523	28,776,646	24,304,600	4,472,046
4.	Total					374,678	$88,352,725	$74,935,600	$13,417,125
5.						Sheet 5			

Appendix B

Sheet 2 of 5

TEXAS EASTERN TRANSMISSION CORPORATION, et al.

Docket No. G-12446, et al.

Cost Treatment Accorded Rayne Gas in Texas Eastern Docket No. G-18841 (Rates Effective December 1, 1959)

Line No.	Particulars (a)	Source Reference (b)	Amounts (c)	Amounts (d)	Amounts (e)
1.	Cost Depletion	TR-R284			$4,213,769
2.	Amortization of Rayne Field Facilities	TR-R284			427,601
3.	Cost of Royalty and Minority Interest Gas	TR-R284			1,612,036
4.	Louisiana Severance Tax	TR-R284			622,548
5.	Subtotal				$6,875,954
6.	Rate Base:				
7.	Rayne Lease and Field Investment:				
8.	Gross				
9.	Accrued DD & A				
10.	Net	TR-R284	$12,206,700		
11.	Return @ 6.25%			$762,919	
12.	Federal Income Tax @ 1.083333			416,553	
13.	Total				$1,179,472
14.	Working Capital — Misc.				—
15.	Deferred Debits Treated as Prepayments		None		—
16.	Total Cost of Rayne Gas				$8,055,426
17.	Unit Cost (34,196,286 Mcf. (15.025 psia))				23.56¢

Appendix B
Sheet 3 of 5

TEXAS EASTERN TRANSMISSION CORPORATION, et al.
Docket No. G-12446, et al.
Cost Treatment Accorded Rayne Gas in
Texas Eastern Docket No. RP64-36
(Rates Effective January 1, 1964)

Line No.	Particulars (a)	Source Reference (b)	Amounts (c)	(d)	(e)
1.	Cost Depletion	TR-R284			$4,213,769
2.	Amortization of Rayne Field Facilities	TR-R284			427,601
3.	Cost of Royalty and Minority Interest Gas	TR-R284			1,612,036
4.	Louisiana Severance Tax	TR-R284			622,548
5.	Subtotal				$6,75,8954
6.	Rate Base				
7.	Rayne Lease and Field Investment				
8.	Gross				
9.	Accrued DD & A				
10.	Net	TR-R284	$12,206,700		
11.	Return @ 6.25¢			$762,919	
12.	Federal Income Tax @ 1.000000	TR-R285		34,511	
13.	Total				1,147,430
14.	Working Capital — Misc. Deferred				
15.	Debits Treated as Prepayments		None		
15.	Debits Treated as Prepayments				
16.	Total Cost of Rayne Gas				$1,023,384
17.	Unit Cost (34,196,286 Mcf (15.025 psia))				23.46¢

Appendix B
Sheet 4 of 5

TEXAS EASTERN TRANSMISSION CORPORATION, et al.
Docket No. G-12446, et al.
Cost Treatment Accorded Rayne Gas in
Texas Eastern Docket No. RP65-59
(Rates Effective June 1, 1965)

Line No.	Particulars (a)	Source Reference (b)	Amounts (c)	(d)	(e)
1.	Cost Depletion	TR-R285			$ 6,287,456
2.	Amortization of Rayne Field Facilities	TR-R285			778,300
3.	Cost of Royalty and Minority Interest Gas	TR-R286			1,984,913
4.	Louisiana Severance Tax	TR-R286			914,056
5.	Subtotal				$9,964,725
6.	Rate Base				
7.	Rayne Lease and Field Investment				
8.	Gross	TR-R286	$14,533,181		
9.	Accrued DD & A	TR-R286	4,319,990		
10.	Net		$10,213,191		
11.	Return @ 6.25%			$638,324	
12.	Federal Income Tax @ .923077			296,968	
13.	Total				$ 935,292
14.	Working Capital — Misc. Deferred Debits	Docket No. RP65-69[1]	$ 8,578,662		
15.	Treated as Prepayments ....Less:	Reduction (Tax accrual offset)	236,131		
		Net Working Capital	$ 8,342,531		
16.	Return @ 6.25%			$521,408	
17.	Federal Income Tax @ .923077			235,818	
18.	Total				757,226
19.	Total Cost of Rayne Gas				$11,657,243
20.	Unit Cost (49,222,022 Mcf (15.025 psia))				23.68¢

Appendix B
Sheet 5 of 5

TEXAS EASTERN TRANSMISSION CORPORATION, et al.
Docket No. G-12446, et al.
Summary of Rayne Field Production Applicable to Conoco, et al (Four-Party Share) Segregated According to Texas Eastern Rate Periods (000 Omitted)

Line No.	Particulars (a)	Source Reference (b)	Production Mcf (15.025 psia) Working Interest (c)	Royalty (d)	Total (e)
1.	Docket No. G-18841 (Rates effective 12/1/59)				
2.	December, 1959	RD — Schedule 3	2,930	613[1]	3,543
3.	Year 1960	Exh. R-19	34,604	7,390	41,994
4.	Year 1961	Exh. R-19	34,953	7,465	42,418
5.	Year 1962	Exh. R-19	38,340	7,744	46,084
6.	Year 1963	Exh. R-19	42,682	9,195	51,877
7.	Total, 12/1/59 through 12/31/63		153,509	32,407	185,916
8.	Docket No. RP64-36 (Rates effective 1/1/64)				
9.	Year 1964	Exh. R-19	39,425	8,296	47,721
10.	January 1 through May 31, 1965	Exh. R 19	16,104	3,414	19,518
11.	Total, 1/1/64 through 5/31/65		55,529	11,710	67,239
12.	Docket No. RP65-59 (Rates effective 6/1/65)				
13.	June 1 through December 31, 1965	Exh. R 19	22,738	4,816	27,554
14.	Year 1966	Exh. R 19	37,070	7,842	44,912
15.	Year 1967	Exh. R-38 and R-35 (work paper D)	40,558	8,499	49,057
16.	Total, 6/1/65 through 12/31/67		100,366	21,157	121,523
17.	Grand Total, 12/1/59 through 12/31/67		309,404	65,274	374,678

18. [1] 97.41% of total royalty production of 628,856 Mcf applicable to Conoco, et al
19. working interest production, per RD — Schedule 3.

Appendix C
Sheet 1 of 2

TEXAS EASTERN TRANSMISSION CORPORATION, et al.
Docket No. G-12446, et al.
Additional Rayne Gas Cost and Texas Eastern Refund
Applicable to the Period July 27, 1959 - December 1, 1959

Line No.	Docket No. (a)	Rate Period From (b)	Rate Period To (c)	Unit Cost ¢/Mcf (d)	Source Reference (e)	Rayne Gas Production Applicable to Conoco et al. MMCF (15.025 #) (f)	Total Cost of Rayne Gas Charged Customers (Col. d x Col. f) (g)	Cost of Rayne Gas at 20¢/Mcf (Col. f x 20¢) (h)	Overcharges by Texas Eastern to be Refunded (i)
1	G-12706	7-27-59	12-1-59	23.62	Sheet 2	11,928 MMCF[1]	$2,817,394	$2,385,600	$431,794

[1] Difference between 3,543 MMCF (App. B, Sheet 5) and 15,471 MMCF (Ex. 35, work paper D)

Appendix C
Sheet 2 of 2

TEXAS EASTERN TRANSMISSION CORPORATION, et al.
Docket No. G-12446, et al.
Cost of Rayne Gas Applicable to period
July 27, 1959 to December 1, 1959[1]

Line No.	Particulars (a)	Source Reference (b)	Amounts (c)	(d)	(e)
1.	Cost Depletion	TR-R284			$4,213,769
2.	Amortization of Rayne Field Facilities	TR-R284			427,601
3.	Cost of Royalty and Minority Interest Gas	TR-R284			1,612,036
4.	Louisiana Severance Tax	TR-R284			622,548
5.	Subtotal				$6,875,954
6.	Rate Base:				
7.	Rayne Lease and Field Investment:				
8.	Gross				
9.	Accrued DD & A				
10.	Net	TR-R284	$12,420,500		
11.	Return @ 6.25%			$776,281	
12.	Federal Income Tax @ 1.083333			423,849	
13.	Total				1,200,130
14.	Working Capital — Misc.				—
15.	Deferred Debits Treated as Prepayments		None		
16.	Total Cost of Rayne Gas				$8,076,084
17.	Unit Cost (34,196,286 Mcf (15.025 psia))				23.62¢

[1] Sheet 2 of App. B Modified

TEXAS EASTERN TRANSMISSION CORP.,
et al.

(Issued August 6, 1969)

WHITE, Chairman, *dissenting* in part.

I cannot agree with the actions of the majority with regard to the refund conditions imposed in the certificates issued to Texas Eastern and the producers. The area just and reasonable rate has been established in our *Southern Louisiana Area Rate Case,* Opinion Nos. 546 and 546-A, Docket AR61-2, and as argued by the New York Public Service Commission it is the just and reasonable rate of 18.5 cents to which the producers should be required to make refunds rather than the 20 cents in-line price. This action by the majority deprives the pipeline's present customers of $7.4 million.[1]

[1] Additional refunds of rates paid by using an 18.5 cents refund level equal $5,799,000. Interest based on 6 percent to March 1, 1960, and 7 percent thereafter amounts to $1,659,000, for a total additional refund of $7,458,000. It must, of course, be recognized that the additional refund lost to *present* Texas Eastern customers is not a total which will be permanently taken away from the whole class of customers. Texas Eastern's contract with the producers calls for payment of $134 million and the Commission does not purport to increase that total price. Thus, the difference between conditioning the price to the 20 cents in-line and the 18.5 cents just and reasonable rates in effect changes the time period over which that $134 million is paid. Rather than depriving Texas Eastern's customers, as a class, present and future, of the total difference between the 20 cents and 18.5 cents rates, the majority imposes on the present customers the cost of the time value of money because these customers are having to pay more now for gas delivered today and in the future. After the special account is amortized, Texas Eastern is to reduce its rates but there is no assurance that the customers who get that gas will be the same customers who have been forced to pay the higher price. Thus, it is impossible to know which customers may simply be paying a cost equal to the time value of the excess payments or which customers may be paying the higher cost without ever getting the benefit of gas deliveries after the note payments and amortization period. The inequity in the majority's holding is obvious but unexplained.

This proceeding was initiated when the four producers sought certification to sell Rayne Field gas to Texas Eastern at 23.9 cents per Mcf and Texas Eastern sought a certificate to construct and operate facilities to attach such gas. The examiner approved all the requested certificates of April 15, 1958, including the 23.9 cents per Mcf price, but after exceptions were taken on the issue of the price, the producer applications were withdrawn and the hearings reopened for Texas Eastern to amend its application to alter its proposed facilities in light of the Lease Purchase Agreement dated December 4, 1958. The Commission granted the certificate sought by Texas Eastern and denied objections by the New York Public Service Commission that the price Texas Eastern would pay for the gas was too high. On appeal by the New York Commission to the District of Columbia Court of Appeals, the Commission's certification was reversed and remanded with the court saying:

> We believe that the Supreme Court meant to impress upon the Commission an interpretation of the "public interest" which, in the context of a rising natural gas market, demands a real administrative effort to hold back prices. We find nothing in the record before us which would justify the conclusion that the Commission had adequately performed this duty. The order, insofar as it grants unconditional certification to the initial price proposals of the producer applicants, is reversed and the case is remanded to the Commission for further proceedings in which the producer applicants may, if they so choose, either augment the record so as to support a certification without price condition, or seek a certification appropriately conditioned. (287 F.2d 146, 150)

After further hearings, the Commission issued Opinion 378 on February 6, 1963, in which it asserted jurisdiction over the lease-sale arrangement. The parties were given additional time to make appropriate filings to correct the

defects. A decision on whether to certificate the facilities proposed by Texas Eastern was deferred but a specific finding was made that

> (6) The construction and operation of facilities subject to the jurisdiction of the Commission as proposed herein by Texas Eastern have not been shown to be required by the public convenience and necessity. [29 F.P.C. 249, 258.]

As a result of the various Court and Commission rulings, gas has been flowing from the Rayne Field into the Texas Eastern pipelines but no valid certificates are outstanding for any of the operations. However, the gas is moving in interstate commerce and the sale cannot be abandoned without Commission approval.

The majority opinion in holding that the refunds should be calculated at a price of 1.5 cents per Mcf *more* than the just and reasonable price, does so essentially on grounds of equity. It is, they say, unfair to make these calculations at a lower initial price than other sales made at the same time merely because what the majority chooses to characterize as "the exigencies of the timing of litigation on similar sales" bring them before us for permanent certification at different times. In my view this reasoning by the majority fails to recognize the true nature of the problem.

The Natural Gas Act establishes but one standard for the lawfulness of rates for sales of gas in interstate commerce for resale. Section 4(a) states "all" such rates "shall be" "just and reasonable." It is, of course, legal for a natural gas company to be certificated to charge rates which have not been found to be just and reasonable. *Atlantic Refining Co.* v. *Public Service Commission of New York ("CATCO")*, 360 U.S. 378 (1959). And where it is permanently certificated to make a sale at an initial rate higher than that which subsequently turns out to be just and reasonable, no refund down to the just and reasonable

level is required. It was the hiatus between certification and determination of the just and reasonable rate which led to the Supreme Court's decision in *CATCO,* holding that the Commission could not ignore the propriety of initial rates of producers on grounds that the just and reasonable rate for the sale would eventually be determined, prospectively, in proceedings under Section 4 or 5 of the Act.

More important to the present case, it was the subsequent attempt of the Commission to meet the requirements of *CATCO* by certificating sales at prices equivalent to those of any contemporaneous sales — without regard to the circumstances of such other certifications — which led to the series of court opinions establishing the "suspect price doctrine" in in-line proceedings.[2] The effect of these decisions was to establish — at least up till now — that the "exigencies of the timing of litigation" do indeed determine the lawful rate a producer may charge. For example, the fact that Pan American was able to charge 24.05 cents per Mcf for a sale in South Louisiana to Trunkline Gas Co. in 1959,[3] because the New York Commission which had sought to oppose the sale and had been denied intervention, erroneously failed to seek review of that action until the grant was made,[4] was held not to justify reliance on that price (as the equivalent Texas in-line prices) in, e.g., *Texaco Seaboard,* 29 FPC 594 (1963); *Turnbull & Zoch Drilling Co.,* 34 FPC 1001 (1965) affirmed, *Continental Oil Co.* v. *FPC,* 378 F.2d 510 (C.A.5, 1967),

[2] *E.g., United Gas Improvement Co.* v. *FPC,* 283 F.2d 817 (C.A. 9, 1960), certiorari denied, 365 U.S. 881; *United Gas Improvement Co.* v. *FPC,* 290 F.2d 133 (C.A. 5, 1961), certiorari denied, 368 U.S. 823; *PSC of N.Y.* v. *FPC,* 287 F.2d 146 (CADC 1960), certiorari denied, 365 U.S. 880, 882; *PSC of N.Y.* v. *FPC,* 329 F.2d 242 (CADC 1964); certiorari denied, 377 U.S. 963; *UGI* v. *Callery Properties,* 382 U.S. 223, 229 (1965).

[3] *Trunkline Gas Co.,* 21 FPC 704 (1959).

[4] *Public Service Commission of N.Y.* v. *FPC,* 284 F.2d 200 (CADC, 1960).

certiorari denied, 391 U.S. 917, 918, 919 (1968). Similarly, it is no longer possible to contend that the existence of a number of sales permanently certificated without opposition in 1958 and 1959, in Southern Louisiana at prices up to 23.55 cents (including at least one sale by Continental, one of the producers here) justifies certification at this level in the present case. The simple fact is that *when* a sale comes before the Commission for final certification has always played an important role in the price it secures.[5]

The previous situations in which the Commission fixed different prices for contemporaneously contracted-for sales of gas from the same area were, it is true, for the most part made, prior to the establishment of the just and reasonable price for the gas, in the context of changing standards for certificating sales.[6] This does not change the nature of the appropriate result here, but only reinforces its inevitability. The Commission opinion reads as though the just and reasonable rate we fixed for first vintage (pre 1961) gas on September 25, 1968, was a determination of the just

[5] Nor can it be argued that there is a distinction where the delay in ultimate certification comes from a producer choosing to litigate a "non-frivolous" issue. In the *Union Texas* case, Opinion 436, 32 FPC 254 (1964), reversed on other grounds *sub nom. Pan American Petroleum Corp.* v. *FPC,* 376 F.2d 161 (1967); reaffirmed on remand, order issued Dec. 18, 1968, rehearing denied, April 2, 1969, a number of producers to a consolidated in-line proceeding had settled their certificate cases and accepted an initial price of 19.0 cents per Mcf off-shore and 20.625 cents per Mcf on-shore within the Louisiana taxing domain. Those who chose to continue to litigate the in-line issue secured only 18.5 cents per Mcf in the Federal domain and 20 cents per Mcf on-shore. In *FPC* v. *Sunray DX Oil Co.,* 391 U.S. 9 at 34, the Supreme Court expressly rejected an argument by Superior Oil Co. that a higher settlement price could influence the proper in-line price.

[6] But see, *Area Rate Proceeding,* AR61-1, Order of November 26, 1968, applying Opinion Nos. 468 and 468-A rates to show-cause proceedings, 40 FPC ...., where certificates for sales between 1961 and 1965 were issued at the *higher* just and reasonable rate, rather than the guideline rate at which uncontested certificates had been issued prior to the *Permian* Decision.

and reasonable rate as of that date, applicable prospectively only. This is, of course, not true. We found that the just and reasonable ceiling price for such gas within the Louisiana taxing authority for all *vintages* of the gas contracted for from 1954, when producer regulation first became effective through the end of 1960, and for all *periods* from 1954 through the date of the opinion,[7] was 18.5 cents per Mcf. Any producer who had charged rates for such gas higher than 18.5 cents per Mcf during any part of the 1954-1968 period, pursuant to increased rate filings allowed to become effective subject to refund after suspension, was directed to make refunds down to this figure. Why, it might well be asked, should a producer who has operated without any certificate for over ten years be able to collect 1.5 cents more than the just and reasonable rate for this period, when a producer which instead chose to accept a certificate at 18.5 cents or less per Mcf and then file increased rates to 20 cents, would be required to refund the difference? Is there to be a premium on delaying permanent certification as long as possible?

The Supreme Court's opinions in the *Callery* and *Sunray DX* cases spell out limited exceptions to the rule that refunds for high rates legally charged prior to final permanent certification should be down to the appropriate just and reasonable rate rather than to a higher in-line rate. But they are not applicable here.

The principal reason relied upon in *Callery* and reiterated in *Sunray DX,*—*i.e.,* the public interest in speeding refunds to consumers in view of the defects in the refund sanction (see *FPC* v. *Tennessee Gas Transmission Co.,* 371 U.S. 145 1962)) is admittedly not present here, since unlike the situations in *Callery* and *Sunray DX* the govern-

[7] Changed to October 1, 1968 by *Area Rate Proceeding,* AR61-2 Opinion 546-A, issued March 20, 1969.

ing just and reasonable determination has preceded permanent certification. The majority thus attempts to tie its determination to the court's alternate suggestion in *Sunray DX,* 391 U.S. at 37, that use of the in-line price as a refund floor might be justified "to assure producers of a firm price." I think it is clear from the context of Justice Harlan's extensive discussion of the problem that the assurance he was discussing was the assurance given to a producer receiving a final permanent certificate, prior to the establishment of the just and reasonable price for the gas, that he will not have to make additional refunds in the future if this just and reasonable price is less than the in-line price. Certainly it could have nothing to do with an assurance that the producer will not have to make refunds from the level he had been charging pursuant to a temporary authorization (to say nothing of the extra-legal operation here), nor to any assurance that the appropriate in-line rate would necessarily be higher than the just and reasonable rate. (*Cf., Area Rate Proceeding, Permian Basin,* AR61-1, 40 FPC ...., order of November 26, 1968, where the just and reasonable base rate for second vintage gas was above the guideline rate at which sales had been certificated.)

The majority also ignores a very basic principle of law that when a certificate or license is reversed by a court, the Commission on remand is under a duty to review the proposal afresh to see that it comports with the public convenience and necessity as of the time it reviews the case. *S.E.C.* v. *Chenery Corp.,* 332 U.S. 194 (1947), *Texaco-Seaboard, Inc., et al.,* 27 FPC 15, 16 (1962). Thus, it is clear that when the original *Rayne Field* opinion was reversed and remanded to the Commission, it had a duty to reconsider the application anew and to see that it was consistent with the public convenience and necessity. This means that the new certificate must contain provisions

which today would be in the public interest even if such conditions would not have been placed in certificates as of the date of the initial opinion. This is true even though the Commission made an error which led to reversal and even though the passage of time during litigation may have resulted in the applicant having additional conditions placed upon him. Thus, the majority's attempt to place the applicants herein in the same position they presumably would have been in in 1959 — or in the same position as other producers who received certificates at 20 cents — does not comport with the duty to insure that the certificate as now issued is consistent with the public convenience and necessity. Indeed, the majority's rationale is not at all consistent with this Commission's treatment of licenses for constructed hydroelectric projects. We have licensed projects constructed many years ago but when we license them, we impose conditions which are found to be in the public interest as of today. We certainly do not issue licenses as we would have had the projects been licensed at the time of construction, and were we to attempt to do so, the courts would undoubtedly reverse our action. We should be no less concerned that producer and pipeline certificates meet the requirements of today and not the conditions of 10 years ago.

Although, as noted in footnote 1 above, the dollar impact of the majority's order may be relatively small in this particular situation, the vice I see in the decision is the establishment and application of a principle that is an indefensible abuse of our obligation to the consumers of this country to ensure that they pay no more than just and reasonable rates for natural gas.

Lee C. White
Chairman

	Docket Nos.
Texas Eastern Transmission Corporation	G-12446
Continental Oil Company	CI66-890
Sun Oil Company	CI66-891
M. H. Marr	CI66-892
General Crude Oil Company	CI66-919

(Issued August 6, 1969)

CARVER, Commissioner, *dissenting:*

This case, which has been before this Commission in one way or another for more than ten years, and which has been reviewed by two Circuits of the U. S. Court of Appeals[1] and by the Supreme Court of the United States,[2] is before the Commission on expectations to two separate decisions of the Examiner,[3] and after at least three orders on interlocutory appeals.[4]

The majority of the Commission has been diligent, as was the Presiding Examiner, Mr. Arthur Fribourg, in the effort to graft a conventional-type, producer-regulated sale of natural gas on the basic skeleton of a sale of gas reserves in their entirety.

My dissent is based upon my conclusion that the Commission and the Examiner have proceeded upon the un-

[1] Public Service Comm. of New York v. Federal Power Comm., 287 F.2d 143 (D. C. Cir. 1960); Marr v. Federal Power Comm., 336 F.2d 320 (5th Cir. 1964).

[2] United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392 (1965). (Rayne Field)

[3] Presiding Examiner's Initial Dec. Docket G-12446, Phase I issued January 23, 1968; Phase II issued September 11, 1968.

[4] Order Denying Stay & Dismissing Appeal, issued December 7, 1967; Order on Certification of Evidentiary Question, issued February 23, 1968; Order Affirming Presiding Examiner in Striking Evidence, issued March 13, 1968.

certain premise that the Supreme Court precluded approval of the transaction presently before the Commission, as a matter of law. This premise is uncertain because the arrangement now before the Commission was *not* before the Supreme Court, and because I read the Court itself to have negatived the idea that such was its intention.

My examination of the history of this case has proceeded from an admitted distaste for retrospective regulation.[5] After an egg has been well scrambled, time can be better spent in seeing that the omelet is edible than in trying to unscramble it. This is even more true where, as here, the likelihood of having to face more lease-sale situations has been effectively foreclosed. Although I do not read the Supreme Court to have invalidated the lease-sale transaction in this case, as supplemented by the reserve-guarantee agreement, it *has* plugged the regulatory gap of transfers of developed gas in place.

Persistent protestations by the producers about the fairness of the procedures in a constitutional due process sense caused me to re-examine minutely the record made in this case, and to come to agree with them that the record deficiencies were the responsibility of the Commission itself. Thus, I have concluded that a remand is necessary in order to have a record which will give a reviewing court the opportunity fairly to dispose of the entire matter. I concede that if the majority's view of what the Supreme Court determined in this case turns out to be correct, then this part of the inquiry will have been irrelevant.

The record deficiencies relate to an absence of data upon which the transaction, taken as an entirety, can be analyzed

[5] See my separate statements in Hugoton Production Co., Op. 556, issued April 17, 1969 and Denman v. J. M. Huber Corp., Op. 562, issued July 23, 1969.

in the light of the situation prevailing at the present time, or at least as of the time when the producers were first before this Commission as applicants for certificates.

The Commission has not been completely clear in its explanation of the differing treatment of the producers and the pipeline. As to the producers, it has "conventionalized" the transaction in part, but it also has gone to the lease-sale transaction for several limiting provisions. Most notably, it has purported to utilize the gross consideration provided in the original contract as the measure of the outside obligation of the pipeline to the producers, whereas in fact it has applied a quite different measure.

The failure in this approach of taking into account the time value of money has been compounded by adding provisions with reference to rates of take, handling of salvage values, and the like, without any record showing that these new provisions are either standard or conventional. And if they are considered to be standard or conventional, then the Commission's majority has not shown why they (particularly the take or pay for provisions) have not been applied in the calculation of the "refunds" found temporarily payable by the producers to the pipeline.

As to the pipeline, the Commission's majority has had to grapple with regulatory inability to indulge in retroactive ratemaking, so that the unscrambling process from the pipeline's standpoint has been handled differently than from the producers' standpoint. The deficiencies of this analysis are also discussed in this dissent.

REGULATION OF THE PIPELINE IN THE PUBLIC INTEREST PRIOR TO OPINION NO. 378

The Natural Gas Act contemplates that there be authorization from the Federal Power Commission before service

begins, if the service is within the regulatory ambit of the Act.[6] The Commission issues pipeline certificates and producer certificates, the latter having been required by the Supreme Court in the *Phillips* case.[7] Since natural gas producers do not easily fit the utility-mold of the Act (pipelines, on the other hand, were much like the carriers regulated by the Interstate Commerce Commission, whose Act was a model for the Natural Gas Act), rate regulation of producers has been in a developmental phase since 1954. Beginning in 1960, when the area pricing concept now being followed was tentatively formulated,[8] until 1968 when the Commission's *Permian* decision was affirmed by the Supreme Court,[9] and continuing in important respects until the present time,[10] the Commission has sought to assure that service by producers begins and continues under certificates which contain conditions adequate to protect the public interest. In other words, for producers the regulatory scheme which is set forth in sections 4 and 5 of the Natural Gas Act is folded into the conditioning power granted in section 7.[11]

6 Natural Gas Act, Sec. 7(e), 15 U.S.C. § 717f(e).

7 Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954).

8 Phillips Petroleum Co., Op. 338, 24 F.P.C. 537 (1960), *aff'd sub nom* Wisconsin v. Federal Power Comm., 373 U.S. 294 (1963); Statement of General Policy No. 61-1, 24 F.P.C. 818 (1960).

9 Area Rate Proceeding, Op. 468, 34 F.P.C. 159 (1965), *aff'd sub nom* Permian Basin Area Rate Cases, 390 U.S. 747 (1968).

10 Area Rate Proceeding (Southern Louisiana Area), Op. 546, 40 F.P.C. ...., (1968); Opinion & Order on Rehearing Op. 546-A, issued March 20, 1969. Hugoton-Anadarko Area Rate Proceeding, Docket AR64-1, Initial Decision issued September 16, 1968, pending before the Commission; Texas-Gulf Coast Area Rate Proceeding, Docket AR64-2, Initial Decision issued September 16, 1968, pending before the Commission. Area Rate Proceeding (Offshore Southern Louisiana, Federal Domain & Disputed Areas) AR69-1, proceeding initiated March 20, 1969, pending before Examiner.

11 Atlantic Refining Co. v. Public Service Comm. of New York, 360 U.S. 378 (1959).

Although producers had been ruled to be subject to regulation before June 23, 1959,[12] transfers of developed leaseholds were not at that time yet conceived to be "sales for resale" of natural gas. Neither had the Commission yet issued its Statement of General Policy initiating the area rate scheme.[13] The regulatory issue which absorbed the attention of the Commission, the industry, and the State commissions in 1959 was how the Commission's conditioning authority under Section 7 of the Natural Gas Act could be applied in order to effectuate the regulatory duties prescribed in the first *Phillips* case.[14]

The Rayne Field owners applied for a conventional certificate to sell the Rayne Field gas to Texas Eastern Transmission Corporation in 1957. The Rayne Field owners' applications for certificates, required by *Phillips*, were consolidated with the application by the pipeline for authority to construct the facilities necessary to connect the gas, Docket G-12446. Both parties received a favorable decision from a Hearing Examiner, Glen R. Law.[15] But the price in the producer contracts, 22.6¢ plus 1.3¢ tax reimbursement, with periodic escalation, was higher than those disapproved by the Third Circuit, when it reversed the Commission in CATCO.[16] The Rayne Field owners, therefore, withdrew their application, which, since service had been neither authorized nor begun, was their right.

The arrangement which was then made by the parties was considered by the Commission. Opinion No. 322, 21

12 When Op. 322 was issued, 21 F.P.C. 860 (1959).

13 24 F.P.C. 818 (1960).

14 Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954).

15 His initial decision is reported at 21 F.P.C. 869 (1957).

16 Public Service Comm. of State of New York v. Federal Power Comm., 257 F.2d 717 (3d Cir. 1958), *aff'd sub nom* Atlantic Refining Co. v. Public Service Comm. of New York, 360 U.S. 378 (1959).

FPC 860, was issued on June 23, 1959, intermediate consideration of the newly agreed upon proposition by an Examiner having been waived by the Commission. Opinion No. 322 amply shows the Commission was not then thought to have been deprived of the regulatory sanctions necessary to protect the public interest. It conditioned the certificate which it granted to Texas Eastern Transmission Corporation, a regulated natural gas company. In doing so, the Commission evaluated the transaction in broad terms which considered, *inter alia*, the size of the block of gas, the needs of Texas Eastern's customers in the future, and the vital importance of these reserves to Texas Eastern.

The Commission did not compute a "cost of service," or "examin[e] into the cost to Texas Eastern of the Rayne Field leases to the extent advocated by the New York Commission."[17] But it *did* examine the question of costs in the broad context of the public interest:

> "We have considered . . . the claimed savings accruing to Texas Eastern from acquiring the leases rather than purchasing the gas under gas purchase contracts; . . .
>
> "The Rayne Field, with recoverable reserves estimated at 988,771,000 Mcf of gas, contains one of the largest single reserves in southern Louisiana. Further, there was evidence of possible additional reserves in untested sands covered by the lease rights . . . Thus there is a good probability that the unit cost of gas to Texas Eastern from the Rayne Field reserves will be even less than the cost computed by the company on the record herein, as discussed below, with consequent additional benefits to the consumers.
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> * * *
>
> "There is no question, however, but that, as stated above, the gas produced from the Rayne Field leases will be available at a cost of at least 2.01 cents per Mcf less than the initial price under the producer contracts; and the difference will be even more favorable to Texas Eastern if, as is reasonable to assume, the reserves are greater than presently anticipated.
>
> "Furthermore, the price Texas Eastern will pay for the Rayne Field leases is fixed for all production from this field, and is not subject to the annual price escalations and indeterminate price increases provided for in the gas purchase contracts. . . .
>
> ". . . Texas Eastern will acquire control over the rate of production, and the minimum take or pay for provisions of the gas purchase contracts will be eliminated, thereby increasing the flexibility of the company's overall pipeline operations."[18]

The Commission disclaimed regulatory interest in the producer-assignors and the Court of Appeals of the District of Columbia, when it remanded Opinion No. 322, did not question the premise that the regulatory "peg" of control over the pipeline was an adequate basis to protect the public interest. That Court said:

> "The relevance of Texas Eastern's acquisition costs to these matters is unaffected by the form of the transaction; the Commission's warrant to inquire arises by virtue of its responsibility to regulate the purchaser, regardless of the status of the seller."[19]

Texas Eastern received a certificate in connection with Opinion No. 322 to construct and operate facilities to connect the Rayne Field supply. Ordering paragraph (D) of that Opinion required the pipeline to certify completion of the facilities, and after this was done, and before January 1, 1961, natural gas began flowing in interstate com-

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[17] 21 F.P.C. at 864.

[18] *Id.* at pp. 864-67.

[19] Public Service Comm. of New York v. Federal Power Comm., 287 F.2d 143, 146 (D. C. Cir. 1960).

merce.[20] It has continued to flow ever since, and absent abandonment authority granted by this Commission, must continue to be dedicated to the interstate market until the field is depleted.

The beginning of gas deliveries massively changed the situation with respect to the subsequent "discovery" of the legal principle that the lease transfers constituted a sale for resale in interstate commerce, and that the assignors were subject to regulation in the status of producers. Until deliveries began, the assignors' continuing right to decline a certificate and dispose of their gas otherwise, or continue to hold it, had consistently been recognized.

In 1957, for example, when the producers applied for a certificate to sell gas under a conventional arrangement to Texas Eastern, Examiner Glen Law, in his consideration (and approval) of the applications, made the following comments:

> "The producer applicants insist that their gas has only been committed to Texas Eastern on the basis of the proposed rates and state that, if conditions are attached, *consideration will be given to the disposition of the Rayne Field gas in markets not subject to this Commission's jurisdiction.*
>
> "As a corollary to the conditions as to rates which they propose, those customers of Texas Eastern who seek such a condition must take the position that Texas Eastern does not need the Rayne Field gas at the price for which it is proposed to be sold to Texas Eastern by the applicants. . . .
>
> * * *
>
> "It is admitted by both the Staff and Texas Eastern that a certificate for the proposed facilities would not

[20] The Presiding Examiner's Initial Decision (on Phase I) of January 23, 1968, gives the impression that deliveries began within a few days of June 23, 1959. A more factual chronology is found in the decision of Examiner Frazee, 29 F.P.C. 259, 264.

> be justified by the record if the independent producers did not make the proposed sales to Texas Eastern, either because the issuance of a certificate is too long delayed *or because the terms of the certificates issued were unacceptable to the producers.*"[21]

REGULATION OF THE RAYNE FIELD PRODUCERS

The dockets now before us include that assigned to the original pipeline application (G-12446), filed on April 22, 1959, and the *pro forma* producer applications filed separately in March, 1966, by Continental, (CI66-890), Sun, (CI66-891), Marr, (CI66-892), and General Crude, (CI66-919). The timing of these filings was dictated by the terms of Ordering Paragraph (B) in Opinion No. 378-A, 30 F.P.C. 153, 157, which gave the producers six months after judicial review became final, to file rate schedules and apply for certificates.[22]

When the Supreme Court reversed the Fifth Circuit[23] and upheld the Commission's contention of jurisdiction over the producers *qua* producers, as asserted for the first time in Opinion No. 378, it said that it was not "impugning in any way the good faith and genuineness of the transactions."[24]

This comment by the Supreme Court has guiding significance, which ought to be applied in resolving the controversies and protecting the public interest. The Court may well have recognized the executed nature of many

[21] 21 F.P.C. 874 & 877, (emphasis added).

[22] It was not until June 29, 1967, that the Commission set this matter for hearing, and the assignor-producers had their first opportunity to present evidence on October 27, 1967.

[23] Marr v. Federal Power Comm., 336 F.2d 320 (5th Cir. 1964)

[24] United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392, 400, (1965).

constituent elements of the case.[25] It is also possible that the Court was impressed with the language of Commissioner O'Connor's concurrence in Opinion 378:

> "I further agree that the case before us must be remanded because in its present form the sale is not susceptible to effective price regulation. The controlling difficulty, I believe, is that the amount of gas being purchased by the pipeline is indefinite, and therefore the ultimate price per Mcf to be charged the consumers cannot be ascertained. Without knowing the Mcf price of this gas, we have no means of determining whether the price paid for it is in the public convenience and necessity. For this reason, I would remand the case for the parties to the transaction to remedy this defect. This can be done by obtaining a guarantee from the producers that the reserves will produce a minimum amount of gas, by obtaining a stipulation from all parties in this case of the minimum reserves, or by producing compelling expert evidence of the minimum figures.
>
> If the transaction is so modified, I believe we will be in a position to effectuate our duties under the Natural Gas Act. It is true that the form of this transaction will still be unusual, and because of this fact it will produce difficulties in techniques of regulation. Particularly, since this transaction contemplates an outright sale of a block of gas for a fixed and certain price, the Commission will have only one occasion to pass on the appropriateness of the price, rather than a continuing jurisdiction to readjust it to changing circumstances. The majority on page 256 of its Order suggests that this difficulty is fatal (although on page 257 it notes that all inplace purchases are not hereby precluded). I thoroughly disagree. There is nothing inherent in a one-shot transaction that precludes effective regulation. All recent regulation of pipeline production has been done on this basis — expenses for outright purchases of undeveloped leaseholds, lands or rights once incurred and approved go into the rate base and are not subjected to continuing adjustments, whether paid for in cash or on an installment basis."[26]

[25] Many more are now also in that category. In September, 1969, for example, the tenth of the sixteen promissory notes will have been discharged.

The Commission cannot fail to consider the possibility that by the time judicial review of this proceeding is ultimately concluded, the predicate for the Commission's action in ordering refunds, rewriting a contract, and rescheduling the flow of consideration may be shown to have been spurious — that the 1959 contract, taken in its entirety, would have been a boon rather than a burden to the interests of the ultimate consumers.

Neither court nor commission has the power to put the parties back to the position in which they were before deliveries began — to unscramble the omelet. From the moment deliveries began, the burden of regulatory responsibility has been to protect the public interest in a case where the scales of bargaining equality had been clamped to permit their movement only in one direction. In other words, once deliveries began in reliance upon the solemn certificate of an authorized agency, the assignor-producers lost irretrievably their opportunity to protect their economic interests in the market place. This is not to be regretted, but neither is it to be ignored. It is not proper to make this circumstance the basis for imposing delictual penalties upon producers. I believe the Supreme Court tried to make this clear.

The Commission's execution of the responsibility to be evenhanded and fair to parties who have lost their bargaining positon by virtue of operation of law, and through no fault of their own, has been something short of profound. For example, in Opinion No. 378-A the Commission

[26] 29 F.P.C. at 259.

rattled the sabre of illegality of previously approved conduct by saying that "without revised filings we would be constrained to deny certificates and, in such case, the parties would be in a position of being in violation of the Natural Gas Act."[27] The fair implication is that not only the producers, but the pipeline as well would have been in continued violation of the Natural Gas Act, if the "revised" filings should be rejected. But no suggestion is syntactically deducible that the past conduct was necessarily illegal. Nevertheless, this assumption is indulged in former Commissioner Ross's dissent to the order consolidating Phase I and Phase II, issued September 26, 1968; he saw illegality in *all* of the producers' conduct, beginning with the withdrawal of the proposed conventional arrangement prior to 1959.

Chairman White's dissent follows the same course. He emphasizes that "no valid certificates are outstanding for any of the operations,"[28] and characterizes the conduct of the producers as "extra-legal."[29] The fact that service was instituted under a Commission certificate *to the pipeline,* and under circumstances which showed that the Commission believed it had ample authority to protect the public interest through its control over the pipeline, including the matter of assuring that the price was not unreasonable, is given no apparent weight.

The Commission speaking through Chairman Joseph C. Swidler came to the belief that jurisdiction attached and ought to be asserted over the transaction by the route of finding that the lease transaction was a sale for resale, and thus that the assignors were regulatable producers. An earlier Commission, under another Chairman, had had

[27] 30 F.P.C. 153 at 156.

[28] Dissenting Statement of Chairman White, p. 3 (memo).

[29] *Id.* at p. 6 (mimeo).

a different view of the law.[30] It seems to me to be unproductive for the Commission ever to use harsh terms with reference to duly authorized conduct, even where, as in this case, a subsequent contrary legal interpretation achieves the approval of the Supreme Court. The actual deliveries have not been invalidated, and having been lawfully begun and never ordered terminated, they should not be tainted as illegal or extra-legal simply in order to make it easier for the Commission now to impose conditions and terms as the circumstances and the public interest require.

Furthermore, the explicit and implicit hint that there has been a more than ten-year course of regulation-avoidance is inconsistent with the Commission's determination that the parties had not been ordered "to execute a particular kind of contract, or any contract"[31] and also with the basic assumption in the majority opinion that the parties' actual transaction is *not* being reformed. In other words, no ascertainable standard of conduct binding upon the parties has been prescribed, the violation of which would constitute illegality; it is the purpose of these very proceedings to establish that standard.

REGULATORY GAP

Akin to the suggestion of illegality is the recurrent suggestion that a regulatory "gap" must be plugged. The fallacy of this argument is that the gap has already been plugged. After the Supreme Court held that this kind of transaction required approval before deliveries could lawfully be undertaken — in other words that the assignor-producers have to be certificated — there has been no possibility of any new Rayne Field type situation arising.

[30] Op. 322, 21 F.P.C. 860 (1959).

[31] Texas Eastern Transmission Corp., Op. 378-A 30 F.P.C. 153, 156 (1963).

Granted that some existing "Rayne Fields" might still require unravelling,[32] the 1965 Supreme Court decision in this case made it final that the Commission would not in the future be confronted with sales in place of proven gas reserves on any theory that jurisdiction did not reach the sellers.

DUE PROCESS

These producers had their first day in court on their contracts with the pipeline in October, 1967,[33] by which time the reserve guarantee suggested to them earlier, had been added.[34] The thrust of their argument is that they have been denied the opportunity to show that the transaction, taken as a whole, is in the public interest and ought to be certified.

This fundamental question has both policy and constitutional due process overtones. The Commission's order of June 29, 1967, consolidating and setting for hearing the certificate applications of the pipeline and the producers, specified that a prehearing conference be convened. At a second such conference, which was called for October 27, 1967, before any testimony had been taken or evidence offered or admitted, the Examiner read from the bench his "tentative decision."[35] This amounted to his legal opin-

[32] *E.g., Bastian Bay*: Federal Power Comm. v. Pan American Petroleum Corp., 381 U.S. 762 (1965) *per curiam* opinion *rev'g* 339 F.2d 694 (10th Cir. 1964); Bastian Bay now pending before the Comm. on appeal from Examiner's Initial Decision issued November 22, 1968, Tennessee Gas Pipeline Co., CP66-269. *Ship Shoal*: Continental Oil Co. v. Federal Power Comm., 370 F.2d 57 (5th Cir. 1966), aff'd Comm. Op. 403, 30 F.P.C. 759 (1963).

[33] Prehearing Conference, October 2, 1967, Tr. R-1 through R-58.

[34] Cf. the language of Commissioner O'Connor in his concurrence in Opinion 378, quoted *supra* p. 10-11.

[35] Tr., R-61 *et seq.*

ion that the Commission and the courts had foreclosed the possibility of the transaction, either initially or as amended in March, 1967, by the addition of reserve guarantee terms, being upheld as in the public interest.

The Commission on December 7, 1967, denied the producers' appeal from this order preserving of course their right to advance their contentions later.[36]

They did make the same contentions later, but it cannot be concluded from the record now before the Commission that a fair opportunity was given to the producers to build a record, either by way of proof or proffer of proof, on their theory of the case. Three separate confrontations between the producers on the one hand, and the Examiner or the Commission on the other hand, were handled in such a way as to establish that the Commission must share fully in the responsibility for fundamental record deficiencies. The first confrontation was, as indicated, the appeal from the Examiner's "Tentative Decision". At that time, as the Commission's order of December 7, 1967, recognizes, it was argued that the producers had been deprived of due process of law in that they had not been afforded a hearing. The Commission order in effect finessed the due process question by stating that if the disputed facts were "legally irrelevant" a further evidentiary hearing might not be necessary, thus leaving the Examiner free to pursue the theory of the case enunciated in his Tentative Decision.

When the Examiner subsequently agreed to strike certain staff and intervenor exhibits on the pipeline's motion, the producers' contentions were not specifically in issue, but the Commission, speaking in the context of the pipeline's motion, said that "in order to avoid all question of

[36] Order Denying Stay and Dismissing Appeal, issued December 7, 1967.

due process . . . [it would] . . . permit all parties to present whatever additional evidence may be appropriate."[37]

However, when thereafter the Examiner granted a further motion of the pipeline to strike the re-offered testimony of producer witnesses Conkling and Webber, the Commission not only sustained the Examiner's ruling,[38] but seemed once again to reject as a matter of law the proposition which the producers had repeatedly tried to put in issue, namely that the transaction as amended by the addition of the reserve guarantee ought to be examined in its entirety in order to determine conformity with the public interest.

It is important, in this connection, to note that the producer witness Conkling, in that portion of his presentation which was stricken, reoffered, and again rejected, was not giving factual testimony, but rather seemed to be laying the foundation for subsequent factual testimony.

This witness asserted that there was more than one way for the Examiner and the Commission to approach the determination of whether the lease-sale transaction could be certified as in the present or future public convenience and necessity. One of the ways he saw was to measure the producer applications strictly from the standpoint of the pipeline. Another was to look strictly to the matter of the producers' unit realization, leaving other questions to pipeline rate cases. Then, in the critical and stricken portion of his testimony, he was asked whether there are

> ". . . facts and circumstances which would justify the allowance of the pipeline's cost of service without

[37] Order on Certification of Evidentiary Question, issued February 23, 1968.

[38] Order Affirming Presiding Examiner in Striking Evidence, issued March 13, 1968.

> modification of the existing leasehold sale even if such cost of service results were higher than the approved in-line rates?

His answer was:

> "Yes, there are a number. It must be remembered that the reserve guarantee given by the producers puts the Rayne transaction on even terms with a conventional gas sale contract insofar as who bears the risk of quantity of reserves — the producers do. In almost all other respects the Rayne transaction is superior to most conventional sales contracts from the pipeline and consumer standpoints. The Rayne transaction does not involve triggering, favored nations, or minimum take-or-pay provisions. Texas Eastern's ownership of the Rayne Field provides economic pipeline flexibility of operations, including complete control of the swing.
>
> "A cost of gas moderately above the in-line price would be more than compensated by the fact that Rayne is a very large field involving little or no gathering costs, and that it is well located with respect to Texas Eastern's system and customers, thus minimizing transmission costs. There is a possibility of cost reduction in the event liquid and gas reserves are greater than those employed in computing costs. In effect, such tail-end excess gas would be free to Texas Eastern and to the consumer assuming flow-through. Most of these facts and circumstances are as stated in the testimony of Texas Eastern Vice President John Jacobs incorporated herein from Docket Nos. G-12446 and G-12447 by reference as Item R-A.
>
> "Also quite important is the fact that the Rayne transaction involves no fixed price escalations. In her testimony, Mrs. Gody shows how it would be appropriate in making an in-line determination to compare the Rayne life-of-the-field price to average contract prices rather than initial contract prices.
>
> "Certainly, in view of all these advantages of the Rayne transaction as compared to conventional con-

tracts, the Examiner and Commission should find the Rayne transaction to be in the present and future public convenience and necessity."[39]

Possibly no due process question would exist if from this or other testimony in evidence the Commission could make appropriate findings. Unfortunately, it cannot. The witness's mention of the impact of the reserve guarantee presents no problem; the Commission is capable of deciding whether the guarantee has the contended-for effect of putting the Rayne transaction on even terms with a conventional gas sale contract insofar as who bears the risk of quantity of reserves. The Commission also has it within its expertise to evaluate how the absence of triggering, favored nations, and minimum take-or-pay provisions might favor the consumers sufficiently to justify consumers assuming the risk of possibly paying more for gas on a cost of service basis than on a straight gas purchase basis.

But the problem is that within this record there is no development of these factors on other than the witness's stated hypothetical basis.

Since the Commission does not, or at least in my opinion it ought not, wish this case to stand for the proposition that there is *no* benefit in a pipeline having the kind of control over production that this transaction gives Texas Eastern, it needs a factual record for its purposes here, even without consideration of the due process question raised by producers. The issue before the Commission here on a factual basis is also before us on a policy basis in the so-called pipeline production case which has been orally argued before the Commission, but not yet decided.[40]

[39] Tr., R-225 through R-227.

[40] Pipeline Production Area Rate Proceedings, RP66-24, severed from the Hugoton-Anadarko Rate Proceedings, 35 F.P.C. 497 (1966).

The witness Conkling's hypothesis that Texas Eastern's ownership of the Rayne Field could provide economic pipeline flexibility of operations, including complete control of swing, is a starting point, but only that. This Commission, having a responsibility under the statute with respect to both present and future public convenience and necessity, ought to go forward with this line of inquiry so that it might have before it such reliable information as the record of how Texas Eastern in fact has operated the Rayne Field during the almost ten years that gas has been flowing. It ought to have informed judgment testimony as to how the pipeline likely will operate the field (assuming it retains full control) in the light of conservatively predictable eventualities of the future.

It ought to have better evidence with respect to past operations. Exhibit R-26, Schedule 3, gives the pipeline's monthly takes, and appears to disclose moderate swings, with some variation from year to year. But the record yields no data as to peak-day takes from which load factor computations can be made. We are left to speculate, based upon our knowledge of the developing gas-shortage concerns of late 1968 and early 1969, that the pipeline might soon be "pulling hard" on the Rayne reserves on a peaking basis. As an expert body, we can also forecast how the operation of the field might change markedly, should the pipeline's efforts to get large offshore contracts be successful. But we could also get testimony on this. We know that as of the present time, most new offshore contracts for new production are 100 percent take-or-pay. We could get evidence as to the value to the pipeline in such circumstances, and to its distributor customers and their consumers, in the existence of the flexibility which the Rayne transaction would afford in avoiding large take-or-pay penalties for the offshore gas.

The deficiencies with respect to due process are incapable of correction by the Commission on the record made, and thus it is our constitutional duty to remand the matter to the Examiner for a further hearing on critical question of whether the lease-sale transaction, as supplemented by the reserve-guarantee provision, is in the public interest. A remand would permit many improvements in the record to be made.

The Examiner also resolutely excluded any testimony concerning the possibility of cost reduction to the pipeline in the event liquid and gas reserves turn out to be greater than those used to compute the costs initially.[41] An informed evaluation of this is also requisite for a fair and impartial consideration of the contention that the transaction in its entirety is more in the public interest than any feasible alternative.[42]

As a final, and possibly peripheral contributing factor to the deficient quality of the record, the posture of the pipeline is worthy of attention.

When counsel for the producers said that he was "surrounded," late in the case,[43] he was accurately summarizing the inexplicable fact that throughout the case to that point, the pipeline was supporting an attack upon the integrity of its own solemn contract with the producers, while at the same time contending for the continued applicability of many of its benefits. The active role of the pipeline in precluding its contracting partner from showing all of the benefits and burdens of the bargain is an aspect of due

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[41] Tr., R-499.

[42] Here again we may note, from his language in concurring to Opinion 378, that Commissioner O'Connor at one time saw several ways of determining this. See p. 10-11, *supra*.

[43] Tr., R-1437.

process deficiency of this record which ought to be corrected.

Of course if the courts ultimately take the same view of the law that the Examiner did, namely that the issue of possible certification of the original transaction as supplemented had been judicially precluded when the Supreme Court ruled on it, the flaws of the record are legally irrelevant. But since the Supreme Court's decision cannot have dealt with factual combinations not then before it, and since no presentation had been made by the producers when the case reached that Court, the Commission now has a special duty to get all the relevant facts in record form. Until this is done, the assignor-producers have been denied the kind of hearing guaranteed to parties of administrative proceedings both by the Administrative Procedure Act and by the Constitution.

In other words, even if the Commission is read to be agreeing with the Examiner that the courts have declared this particular transaction as beyond the pale of the public interest, it ought to permit a record to be assembled which will permit the question to be fairly reviewed.

LIMITING THE PRICE TO THE FACE OF THE CONTRACT

The majority of the Commission believes, although it does not say so very clearly, that the lease-sale transaction as augmented by the reserve-guarantee provision, is incapable, as a matter of law, of being shown to be in the public interest. No other hypothesis of its legal rationale supports its treatment of the contentions respecting due process made by the producers.

It seems illogical, therefore, to find the Commission turning to the agreement between the parties as the source of

so many of the terms of the conditioning orders attached to the certificates "proffered" to the producers, and to the pipeline.

The most significant of these conditions is one which holds the producers to a dollar realization under the conventionalized arrangement equal to the face value of down payment and interest-free notes in the 1959 contract, $134,395,700.

The majority's stated objective that the producers should realize their "full contractual price of $134,395,700," but only that, concedes that under a conventional arrangement, the producers would be entitled to payment of the just and reasonable area price as long as deliveries continued. "Conventionalizing" this transaction in that respect, thus might require the pipeline to pay more, ultimately, than the 1959 contract provided. To forestall such an eventuality the Commission has conditioned its certificate to the producers to provide that when they have delivered an amount of gas which is the dividend of a fraction with $134 million (rounded) as numerator[44] — and 18.5¢ as denominator they will be considered to have been fully paid. At that point the 1959 contractual agreement, which calls for one of the producers (Continental) to operate the field for the pipeline, becomes the model selected by the Commission for additional certificate conditions so that the pipeline will continue to have the benefit of this part of the agreement. Such is the import of ordering paragraph C, except for certain modifications specified in subparagraphs C(1)(e), C(10), and C(11A).

Since the $134 million figure, as the uncontroverted record and indeed the Commission's own Opinion shows, con-

[44] See paragraph 32 (mimeo) of the Commission Opinion.

tains both a principal and interest component, (being stated interest-free), the use of that figure to represent the cut-off period for payment of the unit price of gas is not rational, because it does not take into account the differential ascribable to the differences in time for payment.

To illustrate, using rounded figures, as of January 1, 1968, the producers had collected $90 million, and were still owed $44 million, under their 1959 contract. Under the Commission's order, the producers must refund $21 million, but will then be owed $65 million. Both sums are equal (90 plus 44 equals 134; 90 minus 21 plus 65 equals 134). In the one case, however, the remaining amount due is to be paid by retirement of the notes in 1975; in the second, by delivery of gas at 18.5¢ per Mcf, which will take until 1985 or later.

Holding the producers to a gross figure, which the Commission itself in other sections of the Opinion recalculated on a discount basis, is unfair, irrational, and illegal, even if the legal position of the majority is fully accepted.

There is a guarded explanation for the Commission's action, revealed in a half-dozen references in the Opinion to factors utterly devoid of record support. On page 10, (paragraph 25), for example, the Commission refers to "[v]arious advantages. . . . available to the parties—among others, tax benefits to the Producers." On page 14, paragraph 32, where the "cut-off" provision is candidly described, it is justified negatively by saying that "if we required continued payments until the Field was exhausted the lease-sale would be, in effect, converted into a conventional sale, *presumably with the corresponding tax conquence.*" Perhaps the Commission or the author of the Opinion knows these tax consequences, but the record is devoid of a discussion or description of them.

I dislike the idea of a dialogue between majority opinion and dissent, but I must observe that footnote 10, on page 16, contains an interesting variety of logic when it says that the cut-off provision does not have the effect of reducing the per Mcf price for the gas. The Commission is invited to postulate an additional volume of gas exceeding the volumes necessary to satisfy the Commission's conditioned certificates — to the extent that the producers thereafter must deliver gas at less than 18.5¢ per Mcf, their unit realization is *pro tanto* reduced. The Commission's contrary fiat cannot change simple arithmetic.

RATES OF TAKE AND OTHER ADDED CONDITIONS

An equivalent outgrowth of the refusal to consider the transaction in its entirety is found in the conditions added with respect to rates of take. Recognizing the inequity of allowing the pipeline unilaterally to control the rates at which it takes the gas — a flexibility which the pipeline has bargained and paid for, presumably — the Commission has grafted to its order the requirement that "future takes be based upon a 20-year schedule for the removal of the gas." This results in a one to 7300 daily ratio, computed on the volume estimates made more than ten years ago. The rate is permitted to be averaged over a yearly period, with "swing" permitted to 65 percent of the required minimum daily quantity.

There is no record basis for these provisions — not for the 20-year period, nor for the 65 percent daily minimum, nor for the absence of a maximum. No reason is shown for using 1959 estimates in 1969. No record basis is shown for permitting takes to be suspended for *force majeure.* If the Commission's selection of a one to 7300 ratio amounts to conventionalizing, it is not shown whether the selected "convention" is a 1959 convention or a 1969 convention.

The ratio is not applied to the calculation of the "refund" which the producers are required to pay. The statement is made, in paragraph 39, pages 16-17, that these ratio and force majeure conditions are "based on the assumption that Texas Eastern will continue to take gas at a normal rate as it has been doing in the past." This statement does not match with what I believe is the only record evidence on this subject, Exhibit R-26, Schedule 3. Under the 1/7,300 ratio, and using the data in Exhibit R-26, Schedule 3, as a data base, the amount of the "overpayment" would have been affected by way of a reduction of the producers' refund obligation. In other words, the producers would have been entitled to a credit by reason of a net underage of takes, so that the "overpayment" would be reduced.

The problem, of course, is more than computational. Under conventional gas sales contracts, the parties negotiate their take or pay for provisions. And in 1959, the Commission had not even generally begun to intrude into these negotiations. In economic effect, take or pay provisions are an aspect of price.

Normally, producers seek to maximize the takes, in order to take advantage of the fact that a dollar today is worth more than a dollar tomorrow; pipeline motivation, on the other hand, is to seek flexibility.

In the lease-sale contract tendered to us for approval in this case, the parties resolved these diverse interests to the satisfaction of each; rapid payment (over 16 years) to the producers, and unlimited flexibility to the pipeline. The Commission's arrangement, is a jerry-built substitute, imposed by fiat.

THE "REFUND"

It is a different and unrelated question whether the "refund" ordered to be paid by the producers should be meas-

ured by a 20-cent in-line price, or the 18.5 cent just and reasonable figure of the Southern Louisiana Area Rate Proceedings, specified in Opinion Nos. 546 and 546-A issued after the Examiner had completed his consideration of this case.

The use of the 20-cent figure as a base for computing the refund by the producers does not alter the Commission's final result of holding the producers to a realization equal to 18.5¢ per Mcf for the total of deliveries necessary to equal $134 million plus. This, as the Commission points out, results in a smaller "refund" figure, and thus makes for a shorter elapsed time for the gross consideration figure of the contract to be reached.

I wish to make it clear, for decisional purposes, that on this narrow point, I concur with the majority, and reject the argument that *Sunray DX*[45] compels a different computation.

The disagreement between the majority and Chairman White on this point assumed, it should be remembered, a premise which I do not accept, namely that the courts have precluded an examination of the public interest aspect of the transaction currently submitted for scrutiny. I believe that a strictly fair application of the rationale adopted by the majority — that it is not controlled by *Sunray DX*, and is free to look to the equity of the situation — would require a record development of the terms and conditions under which the producers would have been tendered a permanent certificate on a conventional basis in 1959. It is a matter within the Commission's official notice that many permanent certificates were granted at prices higher than the 18.5 cents used for both ultimate price, and the 20-cent level used for refund calculations.

[45] Federal Power Comm. v. Sunray DX Oil Co., 391 U.S. 9 (1968).

NON-MONETARY VALUES AND UNCERTAINTY

The Commission, by the addition of take-or-pay for provisions, minimum daily takes, and provisions respecting salvage values and other efforts, has recognized that cents-per-Mcf is not the beginning and end of its inquiry. Other non-monetary aspects of the contract, however, have received little or no attention: the value to Texas Eastern of having a major supply of gas without any escalations in price and without any triggering impact on the pipeline's other purchases; the past, present and foreseeable future benefits to the pipeline of the flexibility of operations inherent in its ownership of this reserve in place; location value, and the size of the reserve. Some of these have been mentioned, but only in a conclusionary sense.

Although not precisely quantifiable, each aspect has value equivalence capable of estimation. The Commission's preoccupation has been with uncertainty as if uncertainty itself was an evil to fatally taint the transaction. Conventional contracts for the sale of gas are attended with uncertainties, too. Indeed, as the Commission well knows, most of the gas now flowing in interstate commerce is attached under contracts which provide for escalations from time to time, with limiting features with respect to rates of takes,[46] and with yet-to-be resolved questions on payment for transportation of liquids,[47] costs of offshore to onshore transportation,[48]

[46] See e. g. Brooks Hall, Docket No. CI68-1393, letter order issued conditioning takes to 1:3650 for the first two contract years; Gulf Oil Corp., Docket No. CI67-813, letter order issued March 29, 1968, conditioned takes to 1:7300. The California Co., Docket No. CI68-763, Shell Oil Co., Docket No. CI68-475, Pan American Petroleum Corp., Docket No. CI68-892, letter orders issued rejecting applications where contract take provisions were based on unknown quantities.

[47] Pipeline Costs Allocable to the Transportation of Liquids, Liquifiable Hydrocarbons, etc. for others, Docket R-338, Notice of Proposed Statement of General Policy issued February 5, 1968. See Tidal Transmission Co., Docket CP68-323, order issued September 4, 1968.

[48] Area Rate Proceeding (Southern Louisiana Area), Opinion 546-A, issued March 20, 1969, Ordering Paragraph C, p. 46 (mimeo).

and even royalty obligations.[49] Some of these factors are inhibited in the granting of certificates, others are not, and the policy of the Commission changes from time to time.[50]

The question is not whether uncertainty exists, but rather whether the uncertainties can be contained within reasonable bounds in the interest of protecting the consumers, while continuing to administer a system of regulation which elicits the necessary new supplies of gas.

The producers who are now applying for a certificate removed one element of uncertainty by their reserve guarantee. Other elements of uncertainty have been removed by the passage of time — it is possible now to see how the flexibility of this arrangement has benefitted Texas Eastern for example. The question before the Commission ought to be whether the remaining uncertainties have the potential of harming the consumer, not whether uncertainties exist.

Dr. J. Rhoads Foster, an expert in the field of natural gas pricing, concluded that the uncertainty as to the cost of Rayne gas purchased by Texas Eastern was less than in the case of an equivalent gas supply under a conventional purchase contract:

> "That the margin of uncertainty may be wide has not been viewed as a barrier to certification if the estimated cost is reasonable in comparison with alternatives and the proposed expenditure is otherwise in the public interest. In the present instance, because of the assurance as to quantity, the degree of uncertainty appears to be less than in the case of most gas investments."[51]

When the Commission provides, as it has, for the consumers to get the benefit of the reserves exceeding the

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[49] Denman v. J. M. Huber Corp., Opinion 562, issued July 23, 1969.
[50] See *supra* note 46.
[51] Tr., R-766.

contract's old price, they are really saying that the cost of gas may well be less in this transaction than in a conventional transaction, and when they provide for the refunds so that the money flow may not be faster than the gas flow, an antipathy to uncertainty is converted into a quite inequitable result.

THE TREATMENT OF THE PIPELINE

Thus far, attention has been directed to the transaction from the standpoint of the record deficiencies, both as a due process responsibility of the Commission with respect to consideration of the transaction in its entirety, and in terms of the deficiencies of the Commission's analysis with respect to "conventionalizing" the transaction by picking and choosing from among the provisions of the parties' agreement, while adding other provisions without record or other justification.

It is time now to discuss how this "conventionalizing" process is applied to the pipeline.

In its previous consideration of this case, the Commission undertook to prescribe how the pipeline should treat the Rayne Field gas from a rate standpoint, so that the consumers would be protected. The majority has undertaken to honor the Commission's own prior orders, as best it can, but it has encountered difficulties in doing so, in the light of the "refunds" it has calculated.

The Commission can calculate the difference between what the producers have realized, and what they would have realized under a "conventional" arrangement, and can order the difference temporarily "refunded" to the pipeline, to be later recouped by collecting for gas after the time it would otherwise have been fully paid for. It has far less maneuvering room, in the case of the pipelines. It can-

not easily adjust past pipeline rates. The economic thrust of the pipeline's receipt of the "refund", and the economic circumstance of its future payment for gas during the stretch-out period, have to be translated into statements by the Commission about how it will treat these matters in present and future rate orders. As to the latter, of course, future Commissions cannot be bound by the Commission's action, so the matter of how the Commission will treat the cost of Rayne Field gas in future rate cases has to be stated most diffidently.

The Commission fouls its own nest, so far as promoting confidence in the integrity of its own pronouncements as to how it will handle certain matters in future rate cases, whenever it sets aside equivalent promises made in the past. In this case, although the majority undertakes to honor the past commitment, it does so in a most bizarre fashion.

When the pipeline sought certification of facilities to attach Rayne Field gas, the Commission was concerned that the consumers not be chargeable with the burden of substantial payments exceeding the gas produced. Particularly, it wanted to assure that it not be permitted to claim any excess in its rate base in future rate proceedings.

In this context, the Commission apparently suggested that there be set up a Miscellaneous Deferred Debits Account, to be used to record the down payment and the payment of the maturing notes, at a Commission-accepted unit of production basis as deliveries were made.

Little light is shed on the subject by the settlements of Texas Eastern's rates in proceedings G-18841, RP64-36 and RP65-59. Nevertheless, the testimony of the pipeline's witness Bufkin, as he introduced Exhibits R-37 and R-38,[52]

[52] Tr., R-1290 through R-1293.

and the testimony of Staff witness Werner, in connection with Exhibit R-36,[53] discloses that *all* of the cost of gas was not charged to the pipeline's customers. Otherwise, there would have been no occasion to set up the Miscellaneous Deferred Debits Account.

In the action taken, the Commission recognizes the entitlement of the pipeline, in the future, to have the equivalence of the treatment this account would get if the transaction between the parties should continue as the terms of their agreement provide. This is done by ordering the creation of a special account, and by providing for its augmentation by an amount equivalent to the rate of return from time to time allowed to the pipeline, compounded annually.

The Examiner would have required the pipeline to write off its unamortized capitalized Rayne Field expenditures to surplus, which would have the effect of providing that *all* of the "refund" from the producers would have to be flowed-through to the pipeline's customers.

The difference between the majority and the Examiner is not an absolute difference, but rather an adjustment strictly related to the "vintage" of consumers deemed to be entitled to the benefits of Rayne Field gas, if gas remains available for delivery after the producers have received their $134 million. Under the majority's interpretation of fairness and equity, the ultimate consumer benefit should come after it is determinable that there will be a melon to split; under the other view, the melon would be split now, with the pipeline left to protect its interests in the future.

Although I generally support the application of principles of fairness and equity, I must point out here, as

[53] Tr., R-1184 *et seq.*

I did in the discussion of the level of the refund, that the underlying premise for setting up the special account is fallacious. Fundamentally, the Commission's treatment of gas purchase costs of a pipeline is to roll in all prudently incurred costs. A disallowance has to be founded upon the theory that the costs have not been prudently incurred.

The underlying predicate for the rate treatment of Texas Eastern has to be the question of the prudence of the expenditure. This is a question not examined by the Commission, and the failure to examine it, and deal forthrightly with the issue under normal ratemaking theories is another major defect of the decisional process in this case.

It seems to be unsound and improper, and redolent with great mischief, so casually and inconsistently to treat capital accounts ordered set up by the Commission. Expenditures are either capital in nature, or they are not. If they are made to acquire a long-life productive asset, as these were, then the expenditures ought not be attributed to the output of the asset during merely the initial years of its useful or productive life. It makes a shambles of accounting to have the dualized, ambiguous treatment of transactions ordered by the Commission's opinion.

The awkward method selected by the Commission to achieve a result consistent with fairness but not with sound accounting theory merely underlines the inconsistency of the Commission's action. Whereas the Commission in originally certifying the pipeline computed a life of the field price for the gas, and kept a handle on the accounting treatment of the money consideration paid by requiring the amounts to be posted to a capital account without any promise or commitment as to whether a return would be allowed on payments exceeding deliveries, the Commission has now resolved that reserved question as one of the

salvageable aspects of the lease-sale transaction — the equivalent of a prepayment for gas.

Timing has dictated a part of the inconsistent and erratic results of this case. Under the rules of this case, the payment of notes — which notes, were taught in law school themselves constituted *payment* — must be related to the deliveries of gas, at some common date. This date, for the purposes of the computations of the opinion, is January 1, 1968, but adjustment must be made down to a date ninety days after the issuance of the order. It is possible, even probable, that the basic legal questions in this case, causing the Commission to divide, as it has, will justify further stays of the effective date, so that even if the Commission should be sustained in every respect, the reconciliation date for a change in the method of payment and change in accounting may be as much as two or more years hence. By then, even more of the transaction will be behind us.

PROTECTION OF CONSUMERS' INTERESTS

The burden upon the ultimate consumers is well-discussed but not well defined, in the Commission's majority opinion. Let us suppose that the assignor-producers had sold the leases, not to a pipeline, but to other parties. If the transferees were subject to regulation and they later sold the gas in interstate commerce, the fact that the Sellers might find, twenty years later, that they would have done better or worse by handling the gas on their own account, would be quite immaterial from the standpoint of the ultimate consumers.

Here the pipeline-transferee is and at all times has been subject to regulation. The Commission has imposed regulation upon it in the past, and may continue to do so in the future — from the standpoint of regulatory sanctions, the gas in the hands of Texas Eastern is in exactly the same status as pipeline production.

The Commission has before it a proceeding to fix the pricing policy for pipeline production. and I doubt that the Commission intends for the present case to stand for the proposition that there can be no advantage to consumers in the pipelines owning production of their own.[54] Neither do I think it is intended to be established that in the circumstances of this case that the Commission is without power to attach regulatory sanctions upon the pipeline to protect the consumers from evils, if evils they be, of prepayments for gas, of having flexibility in takes, of being able to take maximum advantage of other gas purchase opportunities on a spot basis, or having large blocks of gas in close proximity to their pipeline system.

In this context, the "uncertainty" of the actual costs which the pipeline will incur in the future by virtue of its bulk-purchase rather than as-taken purchase of natural gas has to be compared with the consumer-benefitting certainties associated with the transaction. In the first place, in this large and well-developed field, the total costs over the life of the reserves which the pipeline must bear

[54] It is perhaps a matter of only historical interest, in the light of the *Rayne Field* decision by the Supreme Court, but I cannot fail to mention the issue of discrimination which may eventually be presented to the Commission as it tries to reconcile this case and the pipeline production case. This issue was surfaced and briefly discussed by Commissioner O'Connor in his concurrence to Opinion 378. He said at 29 F.P.C. 259:

> To make this regulatory inconvenience a controlling factor would be to rule out in place purchases by pipelines since it would eliminate the attraction to producers of receiving a firm price for a completed sale of a defined block of gas. The net effect would be that a pipeline with the staff, facilities, and finances for exploration and development could obtain its own production with all the advantages thereof, but a pipeline not in a position to carry out an exploration program could not obtain its own production by purchasing proven reserves in place. Such a result, I submit, would be violative of the public interest.

in the place and stead of the original owner-seller, if the transaction were conventional, are not even remotely likely to fall outside the range of the equivalent costs included in the determination of just and reasonable prices of natural gas of a particular vintage, plus the non-cost incentive increments which the Commission might possibly add for these vintages in the future, if it should turn out that incentives of this nature were needed to elicit new exploratory effort. The pipeline is regulated; the Commission has a control over the rate implications of these costs which it cannot possibly deny and which it ought not denigrate.

The range of uncertainty is extremely narrow, in any event. And these uncertainties must be evaluated in the light of one additional certainty which the pipeline has acquired, namely the reserve guarantee.

And finally, to return to the real nub of the matter, the "windfall" to the producers, if such should finally appear to eventuate, would be a burden upon the consumers only if a Commission should permit it to be so. The Commission has it within its power to see that this is not a burden. On the other hand, if the consumers have received compensating advantages, in the judgment of the regulators, then a *real* balance is our objective, not the *apparent* balance of monetary consideration above.

As is apparent, my view of this case is that both the Examiner and the Commission have unfairly and improperly evaluated the entirety of the transaction. The four producing companies have been denied fair treatment, first by the error of the Examiner's view of the scope of the Court's denunciation of the contract as signed; then by fracturing the case in order to place all the emphasis on an assumption that the egg could be unscrambled by a

system of refunds; and briefly by issuing exclusionary rulings on the evidence offered.

These errors might be capable of being corrected by the Commission, but they have not been.

CONCLUSION

This Commission does not serve well the interests of sound and effective regulation of the natural gas industry by adopting formulary and stilted reconstruction of a transaction which was apparently lawful and regular when executed. The protection of the public interest, and the interests particularly of the ultimate gas consumer, demands a response based upon more and better data and analysis than that presented by the record.

The question of whether the consumers have received valuable advantages from the unitary transfer of this reserve in place is not beyond the capacity or capability of the Commission, particularly where ten years operating experience is available for guidance. Impliedly, the Commission has recognized that the transaction presented the distinct possibility that the unit cost of gas to the consumers eventually could be even less than the in-line or just and reasonable rates subsequently determined — not to speak of the virtual certainty of their being less than the level at which the transaction *could* have been permanently certificated — because it has undertaken to preserve the benefit of this eventuality by the provision for the cut-off of payments from the producers, inconsistent with a conventional gas sale transaction.

The existence of the reserve guarantee has precluded disadvantage of the consumers in the other direction, even though it would seem that if the consumers have a chance to benefit, they might well be expected to pay for the

advantage. Such, at least in my view, is the issue before the Commission in the pending proceeding for the devising of a policy for pricing pipeline-owned production.

The Commission's differences with Chairman White point up another relatively undiscussed aspect of the Commission's dilemma, namely that concern for the welfare of consumers in cases like this where retrospective regulation is involved is not so much a concern in absolute terms, as it is in "generations" of consumers. Because Texas Eastern's rates cannot be retroactively changed, the benefit of the refund and the burden of the subsequent re-collection of the refund, as well as the benefit of the cut-off provision lifted from the lease-sale transaction, are allocated between today's and tomorrow's customers. Yesterday's customers are beyond the regulatory reach.

Commissoner Brooke joins me in this dissent.

JOHN A. CARVER, JR.
John A. Carver, Jr., Commissioner

APPENDIX G

OPINION NO. 565-A, "OPINION AND ORDER ON REHEARING CONFIRMING ORIGINAL OPINION AND ORDER WITH MODIFICATIONS" OF THE FEDERAL POWER COMMISSION ISSUED SEPTEMBER 29, 1970

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

OPINION NO. 565-A

	Docket Nos.
Texas Eastern Transmission Corporation	G-12446
Continental Oil Company	CI66-890
Sun Oil Company	CI66-891
M. H. Marr	CI66-892
General Crude Oil Company	CI66-919

OPINION AND ORDER ON REHEARING CONFIRMING ORIGINAL OPINION AND ORDER WITH MODIFICATIONS

Issued: September 29, 1970

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

CERTIFICATES (Independent Producer), CERTIFICATES (Lease-Sale) CERTIFICATES (Conditioned), REFUNDS (Independent Producer), REFUNDS (Lease-Sale), REFUNDS (Flow-through), ACCOUNTING, RATES (Pipeline)

Before Commissioners: John N. Nassikas, Chairman; Lawrence J. O'Connor. Jr., Carl E. Bagge, John A. Carver, Jr., and Albert B. Brooke, Jr.

	Docket Nos.
Texas Eastern Transmission Corporation	G-12446
Continental Oil Company	CI66-890
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General Crude Oil Company	CI66-919

OPINION NO. 565-A
OPINION AND ORDER ON REHEARING CONFIRMING ORIGINAL OPINION AND ORDER WITH MODIFICATIONS

(Issued September 29, 1970)

NASSIKAS, Chairman:

1. This proceeding relates to the transfer of gas leases in Southern Louisiana by the Producers, Continental Oil Company, Sun Oil Company, M. H. Marr, and General Crude Oil Company to Texas Eastern Transmission Corporation under a lease-sale arrangement by which Texas Eastern acquired the leases in return for a down payment and a series of notes to be paid over a period of sixteen years representing a purchase price of $134,395,700. In

our original opinion and order we granted certificates of public convenience and necessity to the Producers and to Texas Eastern; conditioned the payments to be made by Texas Eastern under the lease-sale arrangement in such a way that Texas Eastern would pay no more than 18.5 cents per Mcf, the Southern Louisiana area price,[1] until the purchase price was paid; provided for refunds by the Producers based on an in-line price of 20 cents per Mcf to October 1, 1968, the effective date of the *Southern Louisiana* decision, and 18.5 cents thereafter; ordered Texas Eastern to flow through the refunds to its customers to the extent the excess Rayne Field costs were borne by them; provided accounting by which remaining Rayne Field cost balances on Texas Eastern's books would be amortized after the Producers had received their contract price; and required the filing of rates by Texas Eastern to reflect reduced Rayne Field costs.

2. On August 6, 1969, the day Opinion No. 565 was issued, an application for rehearing was filed by General Crude, and later applications were filed by the Public Service Commission of New York. Texas Eastern, Brooklyn Union Gas Company (Brooklyn Union), and, jointly, by Continental, Sun and Marr. The Commission granted rehearing for purposes of further consideration to General Crude on September 2, 1969, and to the other applicants on September 18, 1969. Although responses to applications for rehearing are permitted by the Commission's Rules where rehearing has been granted (§ 1.34(d)), no responses have been filed.

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[1] *Area Rate Proceeding*, 40 FPC 530, Docket Nos. AR61-2, *et al.*, issued September 25, 1968, order on rehearing 41 FPC 301 (1969); aff'd *Southern Louisiana Area Rate Cases, Austral Oil Co., et al.* ....F. 2d.......... (CA5), issued March 19, 1970; petitions for certiorari pending.

3. After considering the applications for rehearing we are of the opinion that most of the points raised are answered directly or by implication in our original opinion and order, and no further discussion is required. However, in several instances valid points have been made, some of which will substantially affect the solution which we present for the Rayne Field problem. As will be developed below, we are of the opinion that many of the considerations expressed in the original opinion which led to our modifying the proposed lease-sale transaction are still applicable. (Commissioner O'Connor concurs in this holding.) However, in the interest of bringing about an equitable result, we are of the opinion that the arrangement prescribed in our original opinion and order should be modified so as to bring it closer to a conventional sale. Accordingly, the Producers, under the modified arrangement prescribed here, will not be limited to the original purchase price of the Rayne Field leases in the amount of $134,395,700, but will receive payment for the gas in the Field until it is exhausted as well as credit for the liquid revenues. (Commissioners Carver and Brooke concur in this modification of the original order.) However, because just and reasonable rates have not been finally determined for the Southern Louisiana area we are deferring any producer refunds, any flow-through to Texas Eastern's customers and any accounting for the Rayne Field investment balances on Texas Eastern's books. We are also deferring any rate reduction by Texas Eastern, which would reflect the modification of the lease-sale arrangement ordered herein, but we shall provide for a refund by Texas Eastern if the producer rates ultimately approved would, in connection with Texas Eastern's other costs, make such a refund appropriate. (Commissioners Carver and Brooke concur in deferring action on refunds and flow-through rate reduction, and accounting.) Our objective, as in Opinion No. 565, is to bring about a result which preserves, as far as possible, the benefits of the transaction, but which meets the public convenience and necessity.

4. We may note that this is the third time the problem has been before us and that it has been twice subject to court review. The transaction was subject to review by the Court of Appeals in 1960 with respect to the certificate granted Texas Eastern. *P.S.C. of New York* v. *F.P.C.*, 287 F.2d 143 (CADC, 1960). After we determined we had jurisdiction over the lease sale transaction, it was subject to review with respect to the question of jurisdiction again in 1964. *Marr* v. *F.P.C.*, 336 F.2d 320 (CADC, 1964); reversed, affirming the Commission in *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965). In the first Court of Appeals opinion the court said we might reopen the record to establish by adequate evidence that the acquisition costs were consistent with the public convenience and necessity (287 F.2d at p. 146). This is the question that was before us when we issued our original opinion and is before us on rehearing.

DUE PROCESS

5. Continental argues that the hearing accorded the Producers was unfair and deprived them of their constitutional and statutory rights in that they were effectively deprived of the opportunity to demonstrate that the lease-sale transaction should be unconditionally certificated. As recounted by Continental, at a prehearing conference on October 2, 1967, the Examiner set a schedule for the submission of evidence and for a hearing, and the Producers on October 9, 1967, served their evidence, but three days later the Examiner issued a notice for a second prehearing conference, which was held on October 27, 1967.

6. At the prehearing conference the Examiner read a tentative decision that it was impossible for the lease-sale transaction to be unconditionally certificated, and he split the proceeding into two parts, the first to determine whether the Producers would be granted certificates at the price to be charged for the future and the second to determine the question of refunds. Continental contends that the Examiner decided the first phase without any hearing at all, that thereafter the second phase was a foregone conclusion and that the inevitable result of dividing the proceeding into two phases was to preclude effectively the Producers from ever developing their theory that the lease-sale transaction could only be properly evaluated as an integrated entity.

7. It should be noted that, with the exceptions discussed below, Producers' evidence was accepted in the record, and the Examiner gave them ample opportunity to set forth their case in briefs filed before him. Thus, Continental's witness O'Leary sets forth a computation of the price to the Producers of the Rayne gas on the basis of expenditures over the life of the field and likewise its witness Conkling shows the cost of the gas to Texas Eastern over the life of the field. In its brief before the Examiner on the "tentative decision" before he issued his initial decision in Phase I, Continental argued at length that, based on this and other evidence, the Producers should be given unconditioned certificates. Therefore lack of an oral hearing in Phase I did not deprive the Sellers of any rights; they had no right to have their witnesses cross-examined. See our order of December 7, 1967, 38 FPC 1125.

8. Continental also complains that the Examiner excluded on Texas Eastern's motion crucial portions of the testimony of witness Conkling. This evidence is not factual, but rather discursive, opinion-type testimony on the impact of his exhibit, which is in the record. The same things could be and were said in the briefs.

9. Continental argues, further, that it was inhibited in presenting its theory of the case by the Examiner's procedural rulings in Phase II, dealing with refunds, striking the testimony of its witness Webber on the value of liquids to be received and refusing to permit cross-examination of Texas Eastern's witness Bufkin on the future benefits from liquid revenues. The question here is whether the Examiner, having admitted evidence in Phase I dealing with the entire life of the field, could eliminate evidence on future periods in Phase II, which dealt with refunds. In our opinion Continental has been permitted to present the lease-sale arrangement in its entirety in Phase I and the evidence on refunds could properly be confined to the past period. See our order of March 13, 1968, 39 FPC 268.

THE LEASE SALE AS A WHOLE

10. Continental argues in several respects that the Commission has failed to evaluate properly the advantageous features of the lease-sale arrangement as presented by the Producers. It says that they have overcome part of the uncertainty by the reserve guarantee and that the Commission faces uncertainty in any major pipeline expansion or hydro-electric license. While, of course, there is always uncertainty, more is involved here, for the proposal is to commit Texas Eastern to a fixed price of $134,395,000 for the life of the field, and that is not true in the conventional certificate proceeding where the price is subject to regulation. The essence of our objection to the lease-sale transaction is its inflexibility. If the price turns out to be too high in the light of changing circumstances, it fails to protect the consumers; if it is too low

the producers will not receive an adequate return and this, in turn, may affect their ability to serve the market.

11. Continental further argues that to evaluate the lease-sale in its entirety the bonus features of the contract must be considered along with the cost evidence. Continental first refers to a virtually unlimited swing or flexibility in operations. The average daily take through the past years, however, was at the approximately normal level of around 1/7700th of the original reserves. It is impossible on this record, and it would be extremely difficult on any record, to appraise the advantage to Texas Eastern of large daily swings. In any case the Commission's opinion now requires a take at the 1:7300 (20 year) level and limits downward swings to 65 percent of this level of takes. We note also that in *Phillips Petroleum Co.* v. *F.P.C.*, 405 F. 2d 6 (CA10, 1969) we were upheld in denying the Producers a price in excess of the area price although the Producers contended their gas had special premium qualities including availability for "swing".

12. Continental also refers to the absence of price escalations, but, as Commissioner Bagge and I point out, the price is in any case subject to area regulation. The reserve guarantee should not be considered of much weight for it guarantees the amount of the reserves, but not the rate at which the gas may be taken and therefore takes no account of the time value of money.

13. Continental also refers to the *Elk City* case, *Panhandle Eastern Pipe Line, et al.*, 27 FPC 35 (1962), where above in-line prices were granted because of distinctly compelling features. In *Elk City* the Commission found that certain gathering, dehydration and compression services were to be rendered by the producer to the pipeline and that additional compensation should be permitted.

Continental says that here not only are gathering, dehydration and compression costs paid for by sellers out of their reserved liquid production payment during the life of that payment, but more than paid for out of liquid revenues accruing thereafter. It should be noted that the area price in the *Elk City* case was a wellhead price, whereas the South Louisiana area price applicable here includes an allowance to the producers for gathering and compression. Moreover, in *Elk City* it appeared that the industry had made an additional investment to provide such services for the pipeline, while here a substantial part of the investment was made for the purpose of liquids recovery. Finally, there is nothing in the record that shows that the Sellers here will perform any unusual services. In fact, in the Assignment and Conveyance costs and expenses incurred by Texas Eastern in the operation of a processing plant or in increasing the compression above 1050 psig would not be included in the cost to be recovered from the sale of separator liquids, and therefore would not fall on the producers. It should be emphasized, as set forth below, that the 20-cent producer price we here require is made expressly subject to later determination upon completion of the area rate proceedings for the Southern Louisiana area.

14. Continental points out that in its consideration of the lease-sale as a whole the Commission referred to the testimony of Continental's witness O'Leary who computed that Sellers' realization from the lease-sale over the entire term amounted to only 16.756 cents per Mcf. Continental states that the Commission is in error in finding that the witness had failed to take into account Texas Eastern's producing costs, which would normally be borne by the Producer. It appears that Continental is correct; the witness credited the expenditures by Texas Eastern with

liquid revenues to be retained by it as reduced by operating expenses. However, as Opinion No. 565 states, the computation made by the witness did not take into account the 22.6 cent price for royalty gas or the time value of money and therefore does not fully represent the cost of the gas to Texas Eastern.

THE COMMISSION'S CONDITIONS

15. Continental argues that the Commission in partially conventionalizing the lease-sale transaction has imposed burdens on the Producers without conferring on them the benefits of a conventional sale, and in doing so has been unfair and confiscatory. Continental notes particularly the provisions of our order which permit the Producers to recover their contractual purchase price of $134,395,700, but require, in effect, that after this has been accomplished they deliver any additional gas free of purchase price and give Texas Eastern the benefit of revenues from liquids produced. Continental also points out that the Commission has not left intact the bargained $134,395,700, for the notes were payable over the first 16 years of production under the lease-sale agreement, but the Commission has extended the period as provided in the majority Opinion No. 565.

16. The Commission in arriving at its solution of the Rayne Field problem was confronted with a contract which had been executed in large part with various benefits, including the benefits received by the parties. The Commission at this stage did not want to undo the transaction, and it chose what it considered an equitable disposition under the circumstances. However, on consideration of the representations made by Continental it appears that while the Producers, under the arrangement we prescribed, will be getting the contract price it will not be of the same

value because they will receive it over a much longer period, and they will not receive the benefit of all the gas and liquids produced by the Field as they would under a conventional contract. Commissioner Bagge and I think, therefore, that it is only equitable that they be paid for the gas and receive credit for the liquids produced until the Field is exhausted. However, we do not seek to undo the whole transaction, for too much time has passed to attempt such a disruptive step. To do equity to the parties it is not essential to revert to the *satus quo ante*. Therefore, Texas Eastern will retain the leases conveyed to it, and will continue to be responsible for operating expenses and necessary investments.

17. This means that the conditions prescribed in this opinion and order with respect to future pricing of the gas from the Rayne Field will be extended until the exhaustion of the Field. Thus Texas Eastern shall pay the Producers the appropriate area rate for the gas produced less royalties, state taxes and investments and expenses for the development and operation of the Field. Under the lease-sale arrangement before the termination of the production payments revenues from liquids are used to reimburse Texas Eastern. Therefore, the area price should be reduced only by unreimbursed investments and expenses, and, after the termination of the production payment, the price should be increased by the liquid revenues.

18. In our original order we required that the Producers file rates based on the rate of 18.5 cents per Mcf prescribed in the *Southern Louisiana Area* case. Since we have stayed[2] this rate as a result of the court's review of our area

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[2] *Southern Louisiana Area Rate Proceeding*, FPC , Docket Nos. AR61-2, *et al.*, issued July 2, 1970; petitions for certiorari pending from the Fifth Circuit's opinion *supra* footnote 1.

decision and the appropriate rate is still subject to further proceedings, we shall require that the producer rate schedule filing be on the basis of 20 cents per Mcf, the in-line price in Southern Louisiana as found in our original opinion. When the Southern Louisiana rate is finally determined, we shall require that this basic producer rate be modified accordingly.

19. We note that Continental attacks the basis of the Commission's "in-line" price of 20 cents in effect until October 1, 1968. It contends that the Examiner in determining the price to be 20 cents ignored the large sales under temporary certificate at 20.625 cents per Mcf and non-settlement volumes sold at prices over 20 cents per Mcf.

20. As noted by the Examiner, the number of certificated prices under long-term contract dated 1958-1960 showed a heavy concentration at the 20.625-cent level — 128 contracts out of 327 and 44 percent of the volume — and a smaller concentration at the 20-cent level — 63 contracts and 27 percent of the volume. The Examiner properly eliminated the rates subject to settlement and so removed from consideration all the contracts at the 20.625-cent level; as a result 20 cents was clearly the price line under Commission precedent. See *Union Texas Petroleum, et al.*, 32 FPC 254 (1964).

21. Continental cites *United Gas Improvement Co.* v. *F.P.C.*, 283 F. 2d 817, 824 (CA9, 1960), certiorari denied 365 U.S. 879 (1961), in arguing that the Examiner ignored the criteria of the courts. While that case says that the price line is intended to reflect current conditions in the Industry and must be based on prices under which a substantial amount of natural gas moves in interstate commerce, there is nothing in the court's opinion that says the

Commission must use prices that result from settlement, which, of course, represents an accommodation of conflicting arguments and positions as stated in the *Placid* case, 30 FPC 682, 683 (upheld as to the in-line price absent the tax in *United Gas Improvement Co.* v. *Callery Properties, Inc.*, 382 U.S. 223 (1965)).

THE REFUND

22. In our original opinion and order of August 6, 1969, we provided for a refund based on the in-line price of 20 cents for deliveries from the commencement of operations in the Rayne Field until October 1, 1968. For the period from this date until the time of payment the refund was to be based on the Southern Louisiana area rate of 18.5 cents per Mcf for 1959 vintage gas.

23. At the present time the question of a refund must be approached in the light of the present state of area price regulation in the Southern Louisiana area. On review of our *Southern Louisiana* area decision, Opinion No. 546 and order in AR61-2, the court indicated[3] that we had authority under Section 16 of the Natural Gas Act to stay, modify or rescind any part of our order, notwithstanding the court's affirmance, if circumstances made a change advisable. The court on rehearing confirmed our authority to reopen any part of the *Southern Louisiana* orders, including those affecting revenues from gas already delivered, and to make retrospective as well as prospective adjustments in the public interest. The court specifically said that the Commission might let its refund orders stand, or, if it found the refunds too burdensome, might remedy the situation by changing its orders.

[3] *Southern Louisiana Area Rate Cases, supra.*

24. The court refused to stay issuance of its mandate affirming our rate determinations in Opinion No. 546, and the judgment was issued as the mandate on July 14, 1970. However, as noted above, we have stayed any rate reductions or refunds required to be made in Opinion No. 546 and order.

25. The result is that the just and reasonable rates applicable to the Southern Louisiana area in which the Rayne Field is situated have not been fully determined, nor has it been determined whether refunds should be made by the producers in that area either for the periods before or after October 1, 1968. In these circumstances it is our opinion that the public interest precludes our ordering refunds to be paid by the Rayne Field producers at this time. The myriad problems confronting the Commission in coping with producer regulation render our task difficult and complex, at best. However, the one objective that must always be kept in sight is the need to provide fair and equal treatment for all of those regulated. It is essential, therefore, that the four producers involved in this proceeding should be afforded the same treatment as will be given to all other producers in Southern Louisiana. In this regard, we believe that the just and reasonable rates which ultimately flow out of any settlement, or further proceedings in AR61-2, or AR69-1, should govern the level of payments in this case prior to October 1, 1968, as well as after that date. While we may find ultimately that refunds should be paid, we need not discuss here the contentions made by Continental with respect to the appropriateness of refunds or their computation (assuming a firm Southern Louisiana area rate).

FLOW-THROUGH OF REFUNDS AND ACCOUNTING ADJUSTMENTS

26. In our original opinion we provided that out of the producer refund to Texas Eastern (amounting to \$21,854,000 plus interest of \$9,595,000 as of December 31, 1967) \$13,848,919 plus interest of \$6,080,371 should be flowed through to Texas Eastern's customers. Texas Eastern was permitted to retain the balance of the refund and was required to reduce the Rayne Field investment balance on its books in the amount of \$20,822,996 as of December 31, 1967, by the amount of the retained refund. The remainder of the investment balance was to be held by Texas Eastern in a special account subject to later amortization. Under the provisions of the present opinion and order producer refunds are not being ordered until the ultimate just and reasonable rate is prescribed. Therefore it is not possible to order any flow-through of such refunds to Texas Eastern's customers until that time. While Texas Eastern and Brooklyn Union make opposing arguments with respect to the flow-through of refunds and the computation of the amount of flow-through we need not discuss these arguments until we take definitive action.

27. Likewise, it is impossible now to determine the amount of Rayne Field investments remaining on Texas Eastern's books or the proper disposition of the balances in the accounts. These amounts, as our original opinion points out, in some ways resemble prepayments but differ from them in that these balances reflect payments for gas as part of the basic transaction calling for payments in the early years of the contract. As such, Commissioner Bagge and I do not think that Texas Eastern's customers should have to pay a return on these balances and so pay for a cost of gas in excess of the in-line price or the just and reasonable area price.

RATE REDUCTION AND NORMAL TAKE OF GAS FOR TEXAS EASTERN

28. Texas Eastern objects to the Commission's condition in the original order that it amend its rate filing in the current Docket No. RP69-13, or other rates in effect (par. 74). It argues that the Commission has no statutory authority under Section 7 to change its system-wide rates. In any future rate proceeding Texas Eastern's cost of purchased gas including the rates paid to the producers here involved would be taken into account. In our opinion, however, it would not now be in the public interest to require Texas Eastern to file new rates to track the producer rate filing here ordered. The 20-cent rate here prescribed for the producers is subject to a final determination made in the *Southern Louisiana Rate Proceeding, supra,* Docket No. AR61-2, or in the *Southern Louisiana Rate Proceeding* in AR69-1. To require Texas Eastern to make a filing now might result in only a temporary reduction to its customers, and thus would bring about only a condition of instability without commensurate benefits. However, in deferring any rate filing by Texas Eastern to track the producer rate filing we shall require that Texas Eastern be subject to refund to the extent its present rates are higher than they would be if they reflected a 20-cent Rayne Field producer rate. With this present disposition it will be unnecessary to discuss Texas Eastern's arguments with respect to the rate filing required by our original opinion and order. Texas Eastern, of course, would also remain subject to our requiring a flow-through of producer refunds if that should be deemed appropriate.

29. Texas Eastern objects to the Commission's condition requiring it to take gas in the future at an annual average daily rate of one 7300th of the reserves estimated as of 1959, saying that the requirement may be

more than the capacity of the wells. Texas Eastern asks that the requirement be modfiied to require delivery at no more than 80 percent of the delivery capacity of the wells. This is reasonable, and our order should be changed accordingly.

The Commission further finds:

The assignments of error and grounds for rehearing set forth in the applications for rehearing present no facts or legal principles which would warrant any change in or modification of Opinion No. 565 and order of August 6, 1969, except as specified herein.

The Commission orders:

(A) The Commission's Opinion No. 565 and order of August 6, 1969, is confirmed as the decision of the Commission with the modifications specified herein.

(B) The certificates issued to Continental, Sun, Marr, and General Crude and to Texas Eastern shall be subject to the following conditions in place of those in ordering paragraph (C) of the original order:

> (1) From and after 90 days from the date of this order and until the termination of gas production in the Rayne Field from the leases transferred to Texas Eastern, no payment subject to the provisions below shall exceed 20 cents per Mcf of natural gas at 15.025 psia (or other applicable area prices determined by this Commission) produced from the entire property that is the subject of the applications, including royalty gas, during the period beginning thirty days prior to the previous installment and ending thirty days prior to the current installment, less the following liabilities paid or incurred by Texas Eastern during that period in connection with Rayne Field or its products:
>
> > (a) Royalties, but from the date of this order no royalties shall be paid until they are approved by Continental for the Producers;

(b) State taxes;

(c) Any investment or expenses incurred for the development or operation of the field or the gathering, movement or treatment of gas or liquids derived therefrom (excepting the operations of LaGloria Oil and Gas Co.) other than transportation of the gas through and beyond the construction by Texas Eastern herein applied for and certificated, except to the extent that such investments and expenses are reimbursed to Texas Eastern under the terms of the agreements between the producer-applicants and Texas Eastern relating to the applications, but from the date of this order no expenses or costs shall be incurred by Texas Eastern in the Rayne Field until they are approved by Continental for the Producers; plus the following items:

(d) net receipts of Texas Eastern from the sale of liquids after completion of the production payments;

(e) any salvage realized by Texas Eastern from any investments; the Producers shall receive payment or credit under this item in the years in which the related physical assets are retired.

(2) The above limitations shall be cumulative, that is, in calculating the amount payable at the time of any installment, the payments and offsets in the foregoing paragraph shall be totalled from the effective date of this order and matched against all previous installments from that date, to the extent paid hereunder, to determine the amount payable on any current installment.

(3) Texas Eastern shall pay the Producers for any salvage realized on any Rayne Field investments that it has not paid them in connection with payments for gas.

(4) Future takes of gas by Texas Eastern from the Rayne Field reserves shall be at least an average daily level of no less than one 7300th of the reserves estimated at the time of the conveyance on July 27, 1959 or 80 percent of the delivery capacity of the wells, whichever is the lesser. This quantity, which shall be averaged over a period of one year, may on a given day be as low as 65 percent of the applicable average daily level of takes.

In the event Texas Eastern is rendered unable, wholly or in part, by force majeure to carry out this provision on its giving notice and full particulars of such force majeure, in writing or by telegraph, to the Producers as soon as possible after the occurrence of the cause relied on, then its obligations so far as they are affected by such force majeure, shall be suspended during the continuance of any inability so caused, but for no longer period; and such cause shall as far as possible be remedied with all reasonable dispatch .

(5) Within 60 days the Producers shall file with this Commission rate schedules, subject to the approval of the Commission effective 120 days from the date of this order which are applicable to the sales herein authorized and which are not inconsistent with this decision, and shall serve a copy on each party to this proceeding who has 20 days within which to submit comments thereon.

(6) Texas Eastern shall be subject to refund to its customers from the date the producer rate becomes effective in accordance with paragraph (5). The refund shall comprise the difference, if any, between what it collects from its customers until refunds are ordered and what it would have collected if it had filed rates reflecting the 20-cent producer rates prescribed by this order.

(7) The following matters in addition to that in paragraph (6) are deferred subject to further order of the Commission: (1) adjustment of the payments between the Producers and Texas Eastern, which may result in refunds by the Producers to Texas Eastern or by Texas Eastern to the Producers for the period

from the commencement of production under the lease-sale arrangement until the adjustment is made, (2) adjustment of the 20-cent basic producer rate used herein, (3) flow-through of any producer refunds to Texas Eastern's customers, (4) determination of the remaining Rayne Field balances on Texas Eastern's books and the ordering of their disposition, and (5) disposition of any amounts to be flowed-through to Texas Eastern's customers.

By the Commission.
(S E A L)

Commissioner O'Connor, concurring in part and dissenting in part filed a separate statement appended hereto.

Commissioners Carver and Brooke, concurring in part and dissenting in part filed a separate joint statement appended hereto.

Gordon M. Grant,
Secretary.

Texas Eastern Transmission Corporation *et al.* } Docket Nos. G-12446 *et al.*

O'CONNOR, Commissioner, *concurring* in part and *dissenting* in part:

(September 29, 1970)

The result reached by a majority of the Commission this day is a culmination of over a decade of proceedings before this Commission and subsequently the courts. As the decisions of the FPC illustrate, including today's decision, it has been almost impossible to formulate a decision which a majority of Commissioners could support. This stems, I believe, from a bona fide effort to treat all those involved

in as equitable a manner as possible. The differences of opinion largely focus on who shall have priority in equity.

The rationale and determinations stated in the previous majority opinion issued on August 6, 1969, are adopted in full herein. (Opinion No. 565, 42 FPC 376) The considerations which produced that decision are equally apt at this time. I cannot approve the lease sale agreement intact as Commissioners Carver and Brooke propose. On this point I concur with the Chairman and Commissioner Bagge. Some aspects of the transaction are, however, in the public interest and the agreement should be approved but as modified in Opinion No. 565. I feel that whereas those modifications are equitable for all affected parties, particularly consumers, the conventionalization approach as espoused in the Chairman's opinion protects neither Texas Eastern's monetary investment nor future consumers who will continue to pay for gas beyond the agreed-upon purchase price of $134,395,700, and may indeed undermine the producers' interests. I consider the treatment afforded the affected parties in Opinion No. 565 to be the most equitable and in the public interest. This dissent will, therefore, elaborate on that rationale.

As noted above, I consider the priorities for equitable treatment to be of major concern. The previous majority and today's dissent are based on considerations of equity in the following order: (1) the consumers who, since the inception of the transaction, have paid excess rates amounting to $19,001,093, including interest to December 31, 1967; (2) Texas Eastern who, having made a full presentation, was certificated by this Commission, 21 FPC 860 (1959), and is responsible for contracting for this reserve of gas which, in my opinion, will be the lowest cost gas of this vintage, including gathering and transmission costs, ever delivered to consumers; (3) the producers should be made

as nearly whole as possible in accordance with the original contract; and (4) the future consumers with whose credit Texas Eastern was able to purchase this gas.

1. Past Consumers

The refund requirement as ordered in Opinion No. 565 is stayed by today's majority. The former majority would require an immediate refund of amounts received by the Producers plus costs incurred by Texas Eastern in connection with Rayne Field less 20 cents per Mcf[1] for gas delivered to Texas Eastern until October 1, 1968. Thereafter, refunds to date would be based on 18.5 cents per Mcf according to that order. However, since the Southern Louisiana area rate may be subject to further adjustment as a result of the court's opinion on review,[2] I feel that an accurate determination of the refund amount for the period beginning October 2, 1968, cannot be made until the Southern Louisiana rate is finally set. Therefore, I would require a refund of amounts received by the Producers plus costs incurred by Texas Eastern in producing Rayne Field gas less 20 cents per Mcf to October 1, 1968.[3] To stay the refunds for this period which is the result reached by a majority of the Commission seems to abrogate the directive of the Supreme Court to compel the payment of refunds at the earliest possible time. *United Gas Improvement Co. v. Callery Properties, Inc.*, 382 U.S. 223 (1965), *FPC v. Tennessee Gas Transmission Co.*, 371 U.S. 145 (1962).

[1] This is the in-line price at which 1959 vintage gas in the Southern Louisiana area would have been certificated.

[2] *Austral Oil Co. v. FPC*, ...F.2d........ (CA5, 1970), application for certiorari to the Supreme Court of the United States pending.

[3] For a detailed discussion of the refund requirement in Opinion No. 565 see Paragraphs 46-47, 42 FPC 376 (1969).

This would provide a full refund to October 1, 1968, of overcharges to Texas Eastern, of which $19,001,093, including interest and computed to December 31, 1967, would be flowed through to the consumers. I would allow Texas Eastern to retain a portion of the producers' refund in order to offset its actual costs which it could not otherwise recover.[4] This, I think, is justified. I cannot accept the argument made by the Public Service Commission of New York that the entire amount of the refund from the producers should be flowed through to the consumers. To flow through the entire amount of the refund would preclude Texas Eastern from recovering its costs. The effect would be that consumers for the past ten years would receive gas at a price below its cost to the pipeline and below the just and reasonable rate. This to me is unconscionable.

2. Texas Eastern

The ingenuity of Texas Eastern in designing and presenting to the FPC this particular package of gas deserves better treatment than the Public Service Commission of New York proposed. Because payments for gas on an Mcf basis are extended for the life of the field, Texas Eastern is precluded from amortizing its expenditures as it would have been able to do under Opinion 565. Texas Eastern presented a planned system expansion based on its proposed transaction in Rayne Field to the FPC for certification. That Commission, in certificating the expansion under Section 7 of the Natural Gas Act, premised its approval, at least in part, on a finding that the public interest was benefited by Texas Eastern's proposed lease sale transaction, 21 FPC 860 (1959). Acting pursuant thereto, Texas Eastern constructed the certificated facilities and paid the

[4] This is specifically discussed in Paragraphs 54-67, 42 FPC 376 (1969).

agreed amount for the gas. Subsequent action by the courts and this Commission notwithstanding,[5] Texas Eastern made the requisite investment upon a certificate issued by the FPC. The integrity of that certificate should be maintained at least to the point of recovering Texas Eastern's investment.

Not only was the expansion certificated but the FPC also approved the accounting procedures to be employed for the purchase. For all practical purposes that accounting has been approved in prior rate settlements and rate cases although the issue of total cost has been reserved for determination herein. The Commission has forced Texas Eastern, for both rate purposes and accounting purposes, into its present dilemma.[6] The extension of payment for gas on an Mcf basis beyond the contract price of $134,395.700 would precipitate the permanent loss of $8,375,089 to the stockholders of Texas Eastern (presumably less any income tax effects). This is manifestly unfair. I believe the previous majority decision would treat Texas Eastern's expenditures in a manner which would be equitable and which would impose no burden on the consumers while permitting Texas Eastern full recovery if the reserves for which it bargained are sufficient.[7]

Action taken by this Commission and the courts in area rate proceedings directly affects the price per Mcf to be paid in this case. If, under the broad latitude given this

[5] For a more complete statement of this lengthy case, see Paragraphs 1-14, 42 FPC 376 (1969).

[6] Under present policies, prepayments of this nature would be includable in the rate base on which Texas Eastern could receive a return on its investment. See *El Paso Natural Gas Co.*, 22 FPC 260, 264 (1959). This is consistent with the principle expressed in the previous majority opinion's treatment of the investment.

[7] See Paragraphs 68-72, 42 FPC 376 (1969).

Commission by the Fifth Circuit[8] and as a result of newly established R-389-A, the wellhead price for Rayne Field gas were increased prospectively, that increase would be reflected in the flow of funds to be paid the producer in the instant proceeding. Assuming *arguendo* the application of the above-mentioned increment, Texas Eastern would, under the previous majority opinion, be able to recover its investment more quickly after the payment of the contract price and future consumers would thereafter receive the benefit of purchase-price-free gas.

3. Producers

The producers made a package sale presumably to escape regulation by this Commission. Obviously, the capital gains features were attractive.[9] The current income tax provisions whereby statutory depletion has been reduced from 27½ to 22½ percent render that sale-in-place all the more profitable comparably if it is continued as a capital gains installment transaction. The previous majority decision upheld the contracts of the producers in every respect except that the bargained-for total compensation would be spread over a longer period. Admittedly, that decision, as does the result of today's majority, extends the pay-out period which denies the producers the value of the use of the money to the extent the sales collections are deferred. However, it is difficult to quantify this value because there

[8] *Austral Oil Co.* v. *FPC*, ... F.2d .... (CA 5, 1970), slip opinion dated March 19, 1970, supplemental opinion dated June 16, 1970, No. 27492 *et al.*

[9] Record, Vol. 6, pp. 29, 173, 430, *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965).

is no way to know today what the just and reasonable rate will be for the life of these properties.[10]

I suggest that this use value of money may be less than the tax consequences to the producers attendant to today's majority decision. Supporting that conclusion is the fact that no producer has, at any time, suggested a conventionalization of this sale as a possible solution.

In other words, I feel that the majority decision of August 6, 1969, will produce as beneficial a result to the producers as the dispositon reached by today's majority.

4. Future Consumers

By supplying Texas Eastern the credit to make the original purchase, future consumers have a definite economic interest in these properties. Today's majority result deprives those consumers of any future benefit whatsoever. This disposition would apply the just and reasonable rate per Mcf until the depletion of the field. The previous majority applied the same rate until the contract price of $134,-395,700 is attained. Thereafter, Texas Eastern would be given the opportunity to amortize its otherwise lost expenditures. After the recovery of that amount, the consumer would receive purchase-price-free gas until the field is depleted.

The value of this purchase-price-free gas is difficult to quantify because it would be determined on the extent of the reserves remaining (based on the original 1959 decision and the majority decision of 1968) after the liquidation of the payments due the producers and Texas Eastern. More

[10] On the other hand, were the area rate to be increased prospectively as hypothesized above the producers would realize the full purchase price more quickly. In that event, the objection to the previous majority decision that the producers would lose the time value of money would not be valid.

importantly, it will be affected by the just and reasonable rates established for this vintage production in future proceedings. As discussed above, if the just and reasonable rate were to be increased prospectively, much of the uncertainty of the benefit to future consumers would be removed. If Texas Eastern can recover its expenditures more quickly, then there is a longer period of time before the depletion of the field in which consumers will receive purchase-price-free gas.

I submit that these prospective gains could be substantial and would be received by future consumers at absolutely no risk. In any case, a prospective benefit to consumers is superior to the payment of the just and reasonable rate for the life of the field which would preclude the possibility of purchase-price-free gas to the consumer.

An additional matter should be considered. The essential difference between today's majority result and my position is the failure of that decision to limit payments to the agreed upon price of $134,395,700 (and, of course, the ramifications of that increased price on Texas Eastern and the consumer). By not adhering to the contract price, the majority allows the producers an additional $52,141,000 (no adjustments included) based on producer Witness Conkling's computations on the life of the field.[11] I do not believe the payment of more than the contract price is warranted as in the public interest.

[11] This assumes a just and reasonable area rate of 18.5 cents/Mcf from and after October 1, 1968. See Appendix A, Sheet 2, Opinion No. 565, 42 FPC 376, 409. ($186,537,000 minus $134,396,000). This figure is not adjusted to reflect the contemplated subtractions of royalties, severance taxes, and unamortized expenditures or the additions of liquid revenues and salvage value in the net price of gas under today's majority result. Of course, if area rates are increased prospectively this amount increases substantially.

Today's result reached by a majority of the Commission pursues a course which conventionalized this lease-sale arrangement. Three courts have reviewed the transaction and, although the options were present, none accepted the lease-sale arrangement in its unaltered form, nor was a conventional sale modification imposed. I believe the responsibility for resolving the inequities of the transaction rests with this commission. The previous majority opinion protects the past and future consumers and allows Texas Eastern to realize its expenditures but maintains the integrity of the transaction to the benefit of the producers. In my opinion, the alternatives presented today fail to accomplish these aims as completely as did the former majority decision.

If there was ever a case that cried for settlement, this is it. I still think all the parties to this proceeding could develop among themselves equitable and acceptable solutions to the many complicated and controversial matters in issue and produce a result more equitable than those reached in any current or past majority or dissent and any solution which may come from court proceedings.

Lawrence J. O'Connor, Jr.
Commissioner

Texas Eastern Transmission Corporation, *et al.*	}	Docket Nos. G-12446, *et al,*

CARVER and BROOKE, Commissioners, *concurring in* part and *dissenting* in part:

(September 29, 1970)

The Chairman of this Commission and Commissioner Bagge have been joined by Commissioner O'Connor in refusing to consider the lease-sale transaction in its entirety. This refusal seems not to be based upon the premise that

the law of the case, as announced by reviewing courts, precludes such action. Had this been the premise, it would have been easy enough to say so, particularly since in our original dissent, we suggested that this be clarified. The opinion of the Chairman and Commissioner Bagge states, in paragraph 4, that "[i]n the first Court of Appeals opinion the court said we might reopen the record to establish by adequate evidence that the acquisition costs were consistent with the public convenience and necessity . . . This is the question . . . before us on rehearing."

Commissioner O'Connor, who signed the original opinion, is the only member of this Commission to adhere to its rationale and determinations. The result reached today is so different from the result which was reached in August, 1969, that a brief summary is needed here to summarize what the Commission has and has not decided, as we see it.

First, it has failed to answer straightforwardly the question posed in paragraph 4 — does the record establish by adequate evidence that the pipeline's acquisition costs were consistent with the public convenience and necessity. We (Commissioners Carver and Brooke) believed that the record was deficient by no fault of the parties, in other words that due process was denied. We believed, and now we are more than ever convinced, that this Commission, as an expert body, has the basis for now finding that the lease-sale transaction in its entirety was and is in the public interest and ought to be confirmed.

Second, the public interest apparently now requires a number of major changes in the result initially announced. No longer do as many as three votes support the following matters decided in the original decision:

a. The producers were required to refund to Texas Eastern so much of its collections under the lease-sale

agreement as exceeded the amount it would have received had it been paid for the gas at 20¢ per Mcf until October 1, 1968, and 18.5¢ per Mcf thereafter, plus interest. Effective on the date of the decision, the producers were to receive no more than 18.5¢ per Mcf for gas as delivered. Producers were denied the benefits of their contract in the matter of liquid revenues. Producers' total realization was to be limited to $134,395,700, the face value of the lease-sale transaction.

By today's decision, no refunds are ordered; producers and the pipeline jointly are required to limit the request for future gas deliveries to 20¢ per Mcf, or other applicable area prices, but producers' total realization is no longer required to be measured by $134,395,700, but rather by the regulated price when it should finally be determined, plus the liquid revenues.

b. Texas Eastern originally was required to make a rate reduction by reason of the reduction of the producers' realization, which reduction was computed to be 0.2¢ per Mcf systemwide. No such reduction is now ordered.

c. Texas Eastern was ordered to make certain accounting adjustments, and particularly denied the right to earn return and related taxes on unreimbursed investment recorded on its books, or to amortize the amounts. This is not now ordered.

The reversal of the original determination to limit the producers' realization to a gross amount of the face of the contract was patently necessary. Chairman Nassikas and Commissioner Bagge apparently prefer to adopt the alternative we discussed of permitting the producers, instead, to receive the regulated rate for the life of the field. Two other alternatives were available — one would be to adjust the realization for the time value of money,

and the other to determine that the original transaction can now be seen to have been a bargain, to the consumers, and to approve it. Reluctantly, we concur in the determination that the regulated price should be authorized for the life of the field, for this is preferable to the confiscation involved in assuming that a dollar paid over two years is equal to a dollar paid in one year. Our concurrence goes no farther.

The same may be said of the matter of refunds — believing none should be made, we concur in an order to defer them as preferable to the alternative of ordering them.

Similarly with respect to rate reductions and accounting adjustments by Texas Eastern, there has never been a hint that Texas Eastern acted other than prudently in acquiring these reserves, nor that it has done other than precisely what the Commission has ordered or approved in its accounting treatment. In the event refunds should be ordered, however, we would agree with Commissioner O'Connor, but regard the matter as decisionally premature at this time.

Our dissent to Opinion No. 565[1] sets forth at length and in detail the legal and policy infirmities of that opinion and resulting order. The modifications adopted today have no significant effect on the most fundamental of these issues; indeed, the modifications tend to highlight them, and to demonstrate their correctness.

When the issues in this proceeding were first presented in 1959, this Commission found that the connection of the Rayne Field reserves to Texas Eastern's transmission system met the standard of public convenience and necessity and should be certificated. Eleven years later, the same conclusion is reached, but it is reached virtually by default.

[1] 42 F.P.C 376, 422-446 (1969).

It is so obvious as to be entitled to little or no discussion, and in particular the Commission has not made any effort to discuss how this matter of the public convenience and necessity of the interstate market getting this gas was originally treated.

Ignored, also, is the fact that we now have, or can get, solid evidence of the benefit to Texas Eastern's customers of their obtaining this block of gas. We can now apply the lens of history to assess the then-contended argument that the producers eventually could have sold this gas and probably at a premium more than compensating for the detriment of waiting longer for a buyer — the argument was sound. Eleven years of regulatory experience has brought this Commission to a realization that the pricing of gas is a complex of many factors, only one of which is represented by the public interest in controlling the realization of producers.

To us, it seems incomprehensible, therefore, that the Commission insists upon conditions of more form than substance, and refuses to relate the transaction to contemporaneous events which show that even the form of the conditions is insupportable.

One stumbling block to resolution of the matter has been the question of the price contracted to be paid for natural gas reserves. The original majority in Opinion No. 565 took the position that this factor can be weighed and determined by one test only: whether the unit cost of the gas included in the transferred leaseholds is equal to or less than that which would be allowed to an independent producer in a fully conventional sale to a pipeline. The standard sought to be applied was the just and reasonable rate it then thought was applicable to the production area. The pricing formula it purported to apply

was not invented until three years after the original transactions in this case had been negotiated and a full year after certification of the facilities involved had been approved.

However much the parties might have been charged with knowledge that six or eight years later (after review by two Circuit Courts and the Supreme Court) their leasehold transfer would be held jurisdictional, it is hardly conceivable that the particular test of "just and reasonable" would be regarded as the sole, mandatory and inescapable result.

Our concern about this test has been reinforced, and in a major sense vindicated, by the modification of Opinion 565 to recognize that we do not know what the "just and reasonable" standard for Rayne Field gas is yet. The standard so confidently applied in Opinion 565 is now very much up in the air.

But before going into this aspect of the matter, it may be useful to "set the stage" by reviewing the earlier proceedings.

When the Commission considered this case in 1959, it recognized that a pipeline could be justified in buying proven gas reserves in place and for a fixed consideration, stating several bases for this conclusion. For example, it found "a good probability that the unit cost of gas to Texas Eastern from the Rayne Field reserves will be even less than the cost computed by the company . . . with consequent additional benefits to the consumer."[2]

The Commission also noted that

> ". . . the company will be able to connect this major gas reserve to its system for a relatively small amount, as contrasted with the many millions of dollars of cap-

[2] 21 F.P.C. 860, 865 (1959).

ital costs involved in laying laterals to the offshore and bay water locations of the only comparable uncommitted gas reserves in Louisiana."[3]

The Commission said in 1959 that from a price standpoint, Texas Eastern could be limited to its actual costs, plus return and related taxes.[4] On the record then made, this came to 20.59¢ per Mcf, but it was noted that this could improve "if, as is reasonable to assume, the reserves are greater than presently anticipated."[5]

A fixed price for the leases certainly relieved the consumers of exposure to price escalations and indeterminate price increases common at that time. Texas Eastern's control over the rate of production, and the elimination of take or pay provisions, was recognized as "increasing the flexibility of the company's overall pipeline operations" to the benefit of the public.[6] Furthermore, in 1959 the Commission explicitly recognized that pipeline-owned production was not unique, and that the transaction had been executed at arm's length.[7]

In several recent orders and proposed rulemaking proceedings, the Commission has invited the parties to submit contracts for review if they are considered by the applicants to be in the public interest, notwithstanding that the price

[3] *Id.* at 866.

[4] *Id.*

[5] "(E)mploying Texas Eastern's estimate of 22.6 cents per Mcf as the maximum amount it would have to pay for royalty and minority interest gas, Texas Eastern's average cost of producing the Rayne Field gas would be 20.59 cents per Mcf, which is 2.01 cents per Mcf less than the initial price the producers originally proposed." F.P.C. at 866.

[6] *Id.* at 867.

[7] *Id.*

may exceed the applicable in-line or guideline rate.[8] The opinion of the Commission in its first consideration of *Rayne Field* could well be the model for the kind of evidence which should be received in such a proceeding, how it should be evaluated, and the considerations which ought to be applied in reviewing the public interest in obtaining a particular gas supply for interstate customers.

Examiner Law's initial decision[9] [which was based on a conventional transaction submitted before the lease-sale agreement was submitted in its stead], also sheds light on the positive side of the acquisition of these reserves apart from price.

He emphasized the magnitude of the reserve, the economy of connecting it to Texas Eastern's system, the absence of any showing by Staff or any intervenor that any similar volumes could be acquired either at a lower purchase price or a lower cost of connecting facilities. Among other problems he pointed out was the fact that behind the applicant producers there were approximately 500 separate lessor interests involved, and great numbers of agreements dependent upon the beginning of deliveries for their validity. The Examiner distinguished between a certificate inquiry and a rate inquiry. Noting uncertainty as to what basis the courts will eventually fix upon as the primary test of the reasonableness of producer rates, he fixed the burden of justification of their rates, "when questioned properly in a rate proceeding," upon the producers.[10]

[8] Notice Expanding Notices of Investigation and Proposed Rulemaking to Nationwide New Gas Sales and Statement on New Applications for Certificates for Sales from all Areas, Docket No. R-389A, issued July 17, 1970. The Commission has received a number of applications referring to R-389A and requesting issuance of a gas sales certificate at the above-ceiling contract price.

[9] 21 F.P.C. 869 (1959).

[10] *Id.* at 880.

The Commission modified the Examiner's decision to recognize the change from a conventional to a lease sale arrangement, but otherwise adopted it.[11] The Commission left intact the Examiner's findings as to the positive public interest aspects of the grant of a certificate to Texas Eastern. Although the D.C. Circuit in its review did not agree with the proposition that rate questions could be deferred until a rate proceeding was started,[12] it did *not* conclude that it was not in the public interest for Texas Eastern to buy this gas other than in conventional form. By making it clear that it did not disagree with the Commission's determination that it had no jurisdiction over the lease sale agreement, the D.C. Circuit left the Commission free to order that in reopened proceedings it would consider whether the cost of Rayne Field gas to Texas Eastern over the productive life of the field was out of line, and whether, if it was, the proposal could still be in the public interest. The Commission's instructions to the Examiner in the reopened proceedings recognized that such was its understanding of its duty.[13]

The reopened proceedings, as conducted by Examiner Frazee,[14] emphasized the first of the two requirements, namely to determine whether the cost of the gas to Texas

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[11] 21 F.P.C. 860 (1959).

[12] Public Serv. Comm'n. of New York v. FPC, 287 F.2d 143 (1960). The court stated: "While it is true that in subsequent rate proceedings instituted under Section 5 the Commission might properly inquire behind the negotiated acquisition costs, . . . the 'nigh interminable' delay associated with such proceedings makes it essential that any proposal under Section 7 be subjected to a most careful scrutiny." *Id.* at 146.

[13] Order Reopening Proceeding, Prescribing Procedures and Fixing Date of Hearing, issued July 14, 1961, Docket No. G-12446, *et al.*

[14] Initial Decision Upon Reopened Proceedings Upon Remand Under Section 7, Natural Gas Act, 29 F.P.C. 259 (1962).

Eastern over the life of the field was out of line — he found it was not. Examiner Frazee's stated ground rules were that he had no jurisdiction over the lease sale as such. He said it was basically immaterial how much Texas Eastern actually paid to the producers, so long as the amount the pipeline was allowed to charge in its cost of service computations was controlled by the Commission, and so long as the original certificate given to the pipeline contained appropriate conditions indicating the tests which should be allowed in making this determination. He had no occasion to reach and did not reach the question of whether, if the price was "out of line" it might still be in the public interest.[15]

The Commission which received Examiner Frazee's initial decision was not the Commission which had sent the case to him. In 1961, an entirely new membership replaced the 1959 Commission.[16] When the Swidler Commission reviewed the case, it did not measure the initial decision against the previous Commission's question about whether the project taken as a whole could be in the public interest.[17] Instead, it directed all its attentions to the underlying legal predicate of lack of jurisdiction over the sale.[18]

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[15] The examiner concluded: "It appears virtually impossible, from the record, to determine the future costs to Texas Eastern for the Rayne Field since they are predicated upon assumptions and estimates. The costs are actually unimportant since the issue here depends upon the base price at which the public interest requires the Rayne Field gas from Texas Eastern. *This 'in line' price will be subsequently developed.*" (Emphasis added) *Id.* at 265.

[16] All of the commissioners participating in the Commission's second *Rayne Field* decision had been appointed by President Kennedy.

[17] Texas Eastern Transmission Corp., Docket Nos. G-12446, *et al.*, 29 F.P.C. 249 (1963).

[18] *Id.* at 252.

In its review of this transaction and the Commission's subsequently asserted jurisdiction to regulate it *per se*, the Supreme Court said: ". . . The sales of leases here involved *were, in most respects, equivalent to conventional sales* of natural gas which unquestionably would be subject to Commission jurisdiction under *Phillips Petroleum Co.* v. *Wisconsin* . . . "[19] (emphasis supplied). The Court did not say that the lease sale *was* a conventional sale of gas, but only that it had the same economic effect. Indeed, it emphasized that there were differences and cited examples. Where differences exist, reason dictates that provision be made to accommodate such variations from the norm.

Even though at the moment it cannot be said what the area rate is, the transaction is still thought capable of being made conventional enough for regulating purposes by applying the area rate as its sole criterion for price measurement. To be sure, differences have been recognized, but in an inconsistent way. Factors which tend to increase price (such as the time value of money, payments for royalty gas, state severence taxes, etc.) are computed and added to unit cost; but cost reduction elements (reduced take-or-pay liability, absence of triggering or price escalations, economics in gathering and storage costs, etc.) are dismissed as inconsequential.

The glaring inconsistency occurs in the determination to allow the regulated price to extend for the life of the field. It takes no particular prescience to guess that there is more than a possibility that the regulated price over the life of the field will escalate to a point where the charge upon the consumers will greatly exceed the outer limits prescribed by the original transaction. Given the volume overruns which were hinted at in the proceedings,

[19] United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392, 401 (1965), *rev'g* Marr v. FPC, 336 F.2d 320 (5th Cir. 1964).

and mentioned in oral arguments, it seemed entirely possible that the consumers would have to pay more than the face value under the rate levels approved in the original Opinion 546 and Opinion 546-A.

For example, a reference to Appendix A to Opinion 565 (42 FPC at 408 and 409), shows that under the lease sale agreement, the cost to Texas Eastern would be $168,900,000 in current dollars (Column, "Net Cost to TETCO", 42 FPC 408). Conventionalizing the transaction to provide that Texas Eastern should pay for the gas as received for the life of the field increases the cost to Texas Eastern to $186,537,000 in current dollars (Col. 3, 42 FPC 409), under the price assumptions of Opinion 565, i.e., 20¢ per Mcf until October, 1968, and 18.5¢ thereafter, if extended, for the life of the field.

The assumption of a level rate for the life of the field has now been fully abandoned. But assuming only the substitution of a 20¢ rate for 18.5¢, the cost to Texas Eastern increases from $186,537,000 to $194,812,000, and proportionately higher if the just and reasonable rate goes above 20¢. The consumers will pay for the privilege of having this transaction regulated "conventionally". Each one-cent increment assumed in the final price approved for Southern Louisiana would add $9,743,000 to the pipeline's costs.[20]

The tables in Appendix A attached to Opinion 565 undertook to show that on a "conventionalized" basis, at level prices, the discounted value of the conventionalized transaction was more advantageous to the consumers than the discounted value of the lease-sale transaction. The relevant

[20] If it is assumed that any higher price allowed in Southern Louisiana will apply *only* to deliveries after October 1, 1968, then the cost to Texas Eastern would increase by $5,519,000 in current dollars for each one-cent upward increment over 20 cents.

figures were $116 million, conventionalized (42 FPC 409, col. 5) to $122.4 million, lease-sale (42 FPC 408, final col.). That comparison becomes disadvantageous to the consumers at just slightly above the increment involved in assuming a level 20¢ per Mcf, where the comparison would be $122.4 million on a lease-sale, discounted, to $120.3 million, conventionalized.

To summarize, the method by which this transaction is forced into the mold of a conventional sale is formulary and doctrinaire and ignores the important differences of which the Supreme Court took note. Its essential evil is that it invites the same consequences which have flowed from formulary methodology in our administration of the Natural Gas Act over the past decade. If ever this Commission faced a situation where it should look to substance rather than form, this is it.

The 1959 Commission's initial consideration of this transaction foundered on the rock of "substantial evidence."[21] In its persistent refusal to compile a full record on all aspects of price, or to discuss them fully and evenhandedly in its opinion, today's Commission courts a similar result in the process of judicial review. A one-sided record is no better than none at all; in terms of our credibility as an objective body, it is undoubtedly worse.

Entirely apart from the issues which have been considered at great length over a long period of time, and particularly in the three view points expressed under Opinion No. 565, the action of the Commission today ignores significant events of the intervening fourteen months. The area rate concept of producer regulation is in more disarray than would be deduced from the fact

[21] Public Service Comm'n of New York v. FPC, *supra* note 13, at 145.

that the Southern Louisiana Area Rate case is not yet final. Among other things, the Commission has opened a second round investigation of Permian Basin producer rates, including an invitation to submit new contracts at "above the line" prices,[22] and it subsequently expanded that proceeding to nationwide scope. The Proceedings in Docket No. R-389 and R-389A contain issues of great importance, including the issue of whether the Commission ought to price gas on an area basis at all.

Particular notice should be taken of the fact that as recently as December 19, 1969, a unanimous Commission approved a settlement agreement which had the effect of ratifying a transfer in place of gas in the Ship Shoal area. In doing so, the Commission made the distinction which we emphasize here, namely that it is possible to separate the terms and conditions to be applied to transferors of gas in place, and those imposed upon a pipeline transferee. The Ship Shoal owners had assigned leases to a pipeline's affiliate in consideration of cash, notes and covenants. The affiliate subsequently assigned its interests to the pipeline. Orders were issued[23] against the producer transferors to show cause why they should not apply for certificates of public convenience and necessity. Thereafter, the transferors agreed to take a reduced consideration for their gas, and the pipeline's affiliate agreed to execute a conventional gas sales contract to the pipeline. In approving the settlement agreement, which undeniably was an approval of a transfer of gas leases in place, the Commission, as a condition of the certificate *to the pipeline*, provided

[22] Notices of Investigation, Proposed Rulemaking and Statement on New Applications for Certificates for Sale of Permian Basin Area Natural Gas, Docket No. R-389, issued June 17, 1970. *See also* note 8, *supra*.

[23] 30 F.P.C. 758 (1963).

that it should "be limited in its cost-of-service in any rate proceeding, with respect to any gas produced from the leases which are the subject of this proceeding, to the cost of production of such gas. However, no cost may be included that is in excess of the just and reasonable area rate for this area as such rate may be determined from time to time by the Commission."[24]

Viewed in its widest perspective, the mischief of the instant case lies in the fact that we seem to have lost sight of the regulatory target. All attention has been concentrated on regulating the producer and his realized price. The objective of assuring fair prices to the consumer at the other end of the pipeline has been overlooked. Producer regulation may assist in that process, but it is not an end in itself.

As has been stated a number of times in this and related cases, the bulk sale of gas through leasehold transfers introduces elements of uncertainty. Our duty is to evaluate those uncertainties in the light of the best information available and to approve or disapprove as the public interest dictates. Extended effort to completely sanitize the transaction against the taint of uncertainty does violence to the judgmental decisions and the risks assumed by the parties. The interests of the ultimate consumer, the proper object of our concern, would be equally or better served by imposing the ceiling rate on the cost of service charge for purchased gas, as was done in *Ship Shoal*.

[24] Tennessee Gas Pipeline Co., a Division of Tenneco, Inc., Docket Nos. CP68-330, *et al.*, Order Approving Settlement Agreement, Permitting Intervention and Granting Certificates of Public Convenience and Necessity, issued Dec. 19, 1969.

[25] Initial Decision of the Presiding Examiner Upon Applications for Certificates, issued January 23, 1968, 42 F.P.C. 446 (1969); Phase II issued September 11, 1968, 42 F.P.C. 455 (1969).

The *Rayne Field* decisions of Examiner Fribourg[25] and Opinion 565 are subject to the criticism that they assume that regulating the producer's realization is the *only way* to protect the public interest. Scant attention is given to the opportunities for such protection which lie in the Commission's control over the pipeline's rates, and over the amount of its costs which it can be permitted to pass along to its customers.

With the changes now made in the original opinion, the question of whether the transaction can be found to be in the public interest, even though the price is "out of line" has been vitiated. It is impossible to assume that the price of the lease-sale is out of line, while also assuming that a much higher realization for the producers is not out of line. However, we will consider the question. If, as a legal proposition, such a result is not judicially precluded (and we believe it is not) then two subordinate questions remain. One is whether the record is presently sufficient to make the determination, and the second is whether the producers have been denied due process in their efforts to make such a record.

For our part, we find sufficient supporting evidence in the record behind Examiner Law's hearing[26] and Examiner Frazee's[27] hearing, and within the body of facts available to this expert agency to support the finding. The transaction in its present form, with the reserve guarantee clause added, has been actively denied a fair hearing. We say this, although we believe that the net result of the Commission's present actions is likely to be beneficial to the producers, and highly detrimental to the pipeline and its customers.

The Commission itself has not turned to any of the original findings, even the uncontroverted ones. Examiner

[26] Note 9 *supra.*
[27] Note 14, *supra.*

Fribourg made it indelibly clear that he had no interest in any matter going to show that the public interest supported the transaction other than on a conventionalized basis.[28] The Commission itself has constructed a highly artificial "conventionalized" arrangements which is demonstrably likely to cost the ratepayers much more than the original transaction.

The Commission purports to answer the contentions by the producers that it has not fairly considered the public interest considerations supporting the transaction as a whole by referring to the evidence tendered, and by explaining that there is no right to have one's own witnesses cross-examined. The duty to assure due process is more fundamental than that.

The Commission responds to the argument that Texas Eastern's acquisition of the right to "swing" on the Rayne Field properties is a bonus feature not properly considered by saying that its "average daily take was at the approximately normal level of around 1/7700th of the original reserves. Apart from the lack of an evidentiary basis for the statement itself, the answer misses the point — it is not whether one collects on an insurance policy which determines the value of having one.

Similarly, the size of the reserve acquired, which was emphasized so much by Examiner Law in 1959,[29] is dismissed as a bonus consideration on the ground that "it would

[28] The examiner stated: "The first consideration is that payments from now on shall be limited to a price required by the public convenience and necessity. This means the in-line price, with the adjustments previously indicated. * * *

This disposition will permit the eventual payment of the entire liability undertaken by Texas Eastern provided the reserves turn out to be as large and the liquids as profitable as the producers expect. Until that liability is fully discharged the producers will receive the same amounts as though they had sold an equivalent amount of gas at the in-line price and, eventually, the area rate." 42 F.P.C. at 453.

be difficult . . . for the Commission to regulate producers on the basis of the amount of gas." In terms of the pipeline and its customers, that is not the issue. The issue, rather, is whether this a bonus feature. The statement that this argument was not persuasive to the Supreme Court in *CATCO* overlooks the fact that *CATCO* was not litigated in the context of the gas supply situation we face today. We believe it entirely possible to "regulate producers on the basis of the amount of gas." Indeed, the Commission has at least started to do so, recently, by initiating a procedure which may result in exempting small producers from regulation.[30]

The Commission's own older precedents for certifying a transaction based on bonus features are distinguished with the unsupported statement that "we do not think that considerations applicable in the Oklahoma area involved in *Elk City*[31] are applicable here." How the situation in Oklahoma differs from that in Louisiana is not explained.

The questions of whether due process standards were met in the hearing and whether the transaction taken as a whole was in the public interest have commanded much of

[29] Note 9, *supra* at 877. The examiner observed that the reserves committed "are among the largest reserves contracted to any pipeline company from a single field in recent years. The Rayne Field contains one of the largest single reserves in South Louisiana and the reserve involved is larger than any single reserve yet developed in the off-shore area. It was the largest uncommitted reserve in South Louisiana being offered for sale, which is reasonably convenient to the line of Texas Eastern, and deliveries can commence as soon as pipeline facilities can be constructed."

[30] Notice of Proposed Rulemaking, Exemption of Small Producers from Regulation, Docket No. R-393, issued July 23, 1970. *See also*, Order No. 402, Statement of Policy, Docket No. R-386, issued May 6, 1970, Policy with Respect to Sales and Deliveries of Natural Gas for Resale in Interstate Commerce, by Companies with Exemptions Under Section 1(c) of the Natural Gas Act to Alleviate Temporary Emergencies, and Order No. 402-A, First Amendment to Statement of Policy, Docket No. R-386, issued June 3, 1970.

[31] Panhandle Eastern Pipe Line Co., *et al.*, 27 F. P. C. 35 (1962).

our attention throughout these proceedings. So much so, indeed, that they have tended to obscure the related due process issue of whether the record, whose deficiencies have been noted, is adequate to support what the Commission has constructed as the alternative with which to compare the original transaction, as modified. A fundamental due process protection of the Natural Gas Act is that a certificate cannot be forced on the applicant. That due process element cannot be preserved where, as here, the legal rules changed after the certificate was first issued. Regulation ought to reply on a concept of fairness where, as here, it cannot restore this protection.

By way of conclusion, it may be useful to review the specifications of error in the applications for rehearing of the various parties, and the treatment accorded each of them by today's action, as we analyze it.

The producers[32] listed seven specifications, lettered A through G. Specification G is a catch-all and will not be discussed. We believe that specifications of error C, D, E, and F[33] have been substantially admitted or mooted by the action of the Commission.

The Specifications A and B[34] seem to us to have merit, although we doubt that the producers will continue to

[32] Application of Continental Oil Co., Sun Oil Co. and M. H. Marr for Rehearing of Opinion No. 565.

[33] C. The Commission erred in only partially "conventionalizing" the lease sale transaction in a manner which has resulted in confiscation of Sellers' property in violation of the Federal Constitution and the Natural Gas Act.

D. The Commission erred in its imposition of refund liabilities upon Sellers relating to payments made by Texas Eastern under the lease sale transaction during the period prior to June 1, 1965.

E. The Commission erred in failing to base Sellers' refund liabilities upon a floor of 20.625 cents rather than 20 cents during the period prior to October 1, 1968.

F. The Commission erred in attaching unreasonable conditions to Sellers' certificates based on findings which lack substantial record evidentiary support.

press them in the light of today's decision. The consumers ought to.

Texas Eastern's specifications are numbered 1 through 13, with only the first ten relating directly to the original opinion. Specifications 1 through 7 have been mooted by deferral of decision or action. These relate to refunds, flow-through, and accounting treatment. Specification 8[35] has been denied, although we think it should have been allowed. Specification 9 has been allowed — Texas Eastern has not been ordered to make a reduction in its systemwide rates. Specification 10 has been allowed, and we concur, although we believe Texas Eastern should have insisted on approval of the lease-sale transaction, as we pointed out originally.

The New York Commission's specifications of error basically have been disallowed *in toto*, although technically many of them are predicated on matters mooted or deferred. The same can be said of the specifications of Brooklyn Union.

The inability of the Commission to agree on a resolution of the problems presented by the *Rayne Field* facts is traceable, in our opinion, to an uncritical acceptance of the Supreme Court's affirmance of the Commission's post-1961 determination that transfers of gas in place are

[34] A. The Commission deprived Sellers of a fair hearing in violation of Sellers' Constitutional and statutory rights to due process of law by its various orders approving the Examiner's procedural and evidentiary rulings during the course of this proceeding.

B. The Commission erred in improperly evaluating Sellers' unrebutted evidence designed to demonstrate that the Rayne lease sale transaction, viewed in its entirety, serves the public interest and should be certificated as proposed.

[35] The Commission erred in finding that the approach of Staff witness Werner "more accurately reflects Rayne Field costs paid by Texas Eastern's customers than the" presentation of Texas Eastern's witness Bufkin (Mimeo p. 23).

jurisdictional as meaning that the transaction must be in a particular "conventional" form. The ultimate absurdity of such an approach is presented by the various views expressed today.

Commissioner O'Connor, who wrote Opinion 565, and adheres to it still, refuses to relax the rigidity of that decision, which refused to carry the conventionalizing process to the point of permitting the producers to be paid for gas as delivered for the life of the field; indeed, he refuses even to recognize that there is no valid reason to apply a gross realization figure from the contract, unless the contract's terms as to the timing of the payment are also applied.

The Chairman and Commissioner Bagge have corrected that defect in the opinion, but in the process have lost sight of the possibility that the original lease-sale transaction is still a viable alternative. Although we concur with the Chairman and Commissioner Bagge because their solution lacks the features of confiscation present in Opinion 565, we must point out that it is an alternative likely to be much more disadvantageous to the regulated pipeline's customers than the original lease-sale transaction.

Finally, by the time the problems raised by this attempt at conventionalization are ultimately resolved, it is virtually certain that the predicate for the refunds, and for the accounting adjustments which have been discussed will have disappeared.

It is time the Commission learned to look at substance, rather than form. In a variety of current situations, the Commission is forced to face reality of the market; in this case, the market reached a fair result, indeed a bargain situation for the consumers.

John A. Carver, Jr.
John A. Carver, Jr., Commissioner

Albert B. Brooke, Jr.
Albert B. Brooke, Jr., Commissioner

APPENDIX H

ORDER OF THE FEDERAL POWER COMMISSION, "ORDER DENYING REHEARING OF OPINION NO. 565-A AND ORDER AND DENYING STAY", ISSUED NOVEMBER 24, 1970

Before Commissioners: John N. Nassikas, Chairman; Lawrence J. O'Connor, Jr., Carl E. Bagge, John A. Carver, Jr., and Albert B. Brooke, Jr.

* * * * *

ORDER DENYING REHEARING OF OPINION NO. 565-A AND ORDER AND DENYING STAY

(Issued November 24, 1970)

Texas Eastern Transmission Corporation and Continental Oil Company, Sun Oil Company, M. H. Marr, and General Crude Oil Company (Producers), on October 29, 1970, filed applications for rehearing with respect to the Commission's Opinion No. 565-A and Order issued September 29, 1970, in the above-entitled proceeding. The Producers have also filed an application for a stay of the rate filing requirement in the order. The Philadelphia Gas Works Division of UGI Corporation (PGW) filed an application for rehearing on October 30, 1970, which the Secretary rejected as such because it was untimely, but provided that it would be accepted as a motion for reconsideration. Texas Eastern has requested oral argument.

* * * * *

In our opinion the questions raised by the Applicants are sufficiently covered by or are clear from the language of Opinion No. 565-A and Order, so that further discussion is unnecessary.

While the oral argument held on April 19, 1968, covers prospective rates, we are of the opinion that other matters have been so well briefed on exceptions to the Presiding Examiner's decision of September 11, 1968, and on rehearing of Opinions 565 and 565-A, that oral argument would serve no useful purpose.

The Commission further finds:

(1) The assignments of error and grounds for rehearing set forth in the applications for rehearing by Texas Eastern and the Producers present no facts or legal principles which would warrant any change in or modification of Opinion No. 565-A and Order of September 29, 1970.

(2) The request for a stay by the Producers, the motion for reconsideration by PGW, and the motion for oral argument by Texas Eastern should be denied.

The Commission orders:

The applications for rehearing filed by Texas Eastern and the Producers, the motion for a stay filed by the Producers, the motion for reconsideration filed by PGW and the motion for oral argument by Texas Eastern are denied.

By the Commission.

(S E A L)

Commissioner O'Connor concurring filed a separate statement appended hereto.

Commissioners Carver and Brooke dissenting filed a separate joint statement appended hereto.

Gordon M. Grant,
Secretary.

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O'CONNOR, Commissioner, *concurring:*

The granting of rehearing at this time would not serve any constructive purpose. Because Rayne Field has received extensive consideration by this Commission and is certain

to be reviewed by the courts,[1] and additional rehearing[2] would not be fruitful. The views of the various Commissioners have been articulated in depth.

Despite my belief that rehearing would not be useful, I continue to adhere to the views expressed in my concurring and dissenting statement to Opinion No. 565-A, dated September 29, 1970. However, I would modify one significant portion of that statement. I am now convinced that the arguments supporting extending the total payment, the amount contemplated in Opinion No. 565, 42 FPC 376 (1969), are justified.

The lease-sale agreement as contracted established a payment period of 16 years. Opinion No. 565 retained the amount to be paid the producers but payments were extended beyond the 16-year period. Whereas the validity of the observation in Footnote 10 of my separate statement in Opinion No. 565-A remains intact,[3] I believe the time value of money must be considered as an element in reaching an equitable disposition of this case. It is clear that $134,395,700 paid over a period in excess of 16 years is unlike that amount paid in 16 years. Therefore, I believe the purchase price should be increased by an allowance for

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[1] On October 5, 1970, Philadelphia Gas Works Division of UGI Corporation filed a Petition to Review Opinion No. 565-A in the U.S. Court of Appeals for the District of Columbia Circuit. On October 19, 1970, the Public Service Commission of New York also filed a Petition to Review in the same court.

[2] No specific provision of the Rules of Practice and Procedure provides for the rehearing of an Opinion and Order on Rehearing where the parties challenging the second order also excepted to the initial order.

[3] That discussion considered the effect on the transaction of a prospective increase in the area rate. Such an increase would accelerate the payments to the producers (since the payments are conditioned to the area rate) which would reduce the impact of extending the payment period.

interest on balances due the producers under the lease-sale agreement for the period that the producers are deprived of the use of these amounts because of the extension of payments affected by conditioning the price of gas to the area rate.

The inclusion of this interest component would, I believe, be more harmonious with the intent of the parties as the lease-sale agreement was drafted without sacrificing equitable treatment of past and future consumers and of Texas Eastern. Payments would continue to be conditioned to the applicable area rate until the $134,395,700 is paid. Thereafter, Texas Eastern and the producers would initiate amortization on a pro rata basis predicated upon the total amount to be recovered by each. Therefore, Texas Eastern would have an equal opportunity to amortize its investment even with the increment in total price to be paid the producers. This treatment seems eminently fair particularly in view of the fact that the producers guarantee of reserves (made subsequent to the initial contract) in effect assures Texas Eastern recovery of its capitalized advancements.

The refund requirement as established in Opinion No. 565 would not be amended. Future consumers would not, of course, receive purchase-price-free gas as quickly as under Opinion No. 565. However, this modification does not appear to significantly alter the retention of the potential benefit of purchase-price-free gas by future consumers.

I believe this additional component in the price to be paid the producers is justified and in the public interest. The modification would not affect the refund obligation as set forth in Opinion No. 565 and would not materially erode Texas Eastern's ability to recover its investment of future consumers' opportunity to receive low-price gas.[4] Even this

[4] As noted in Footnote 3 the effect of this amendment would be diminished if the area rate were increased prospectively.

increment in purchase price does not alter my already-stated belief that this is the lowest cost gas of this vintage, including gathering and transmission costs, ever delivered to consumers.

Polarized views concerning this case have not dissipated; no effort has been made to find an acceptable point of agreement. Whereas I believe the disposition of this case as stated in Opinion No. 565 and in my statement in Opinion No. 565-A, as modified here, is the most equitable to all concerned and protects the consumer, I still believe that all the parties should be able to develop an acceptable settlement which would preclude lengthening these already-protracted proceedings. I am firmly convinced that the parties themselves are in a far better position to weigh the values intrinsically involved in the transaction and determine a more equitable resolution of differences for all concerned. A settlement might be preferable to any decision by those far removed from the transaction.

/s/ Lawrence J. O'Connor, Jr.
Commissioner

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(November 24, 1970)

CARVER, Commissioner, and BROOKE, Commissioner, *dissenting:*

Commissioner O'Connor's recognition that the Producers are entitled to an allowance for interest on balances due them under the lease-sale agreement to compensate them for a time stretch-out in their payments necessitates a further exposition of our position.

As we emphasized in our statement filed with Opinion No. 565-A, we had an uncomfortable choice between out-

and-out confiscation of a part of the producers' bargain and assuredly higher costs to the consumers. We opted against bald confiscation.

The confiscatory aspect of limiting the producers' realization to $134 million gross has now been eliminated, and a different choice faces us. Shall we agree, at long last, with the theory of the original majority that the public interest requires a retrospective rewriting of the contract, either with the adjustments suggested by Commissioner O'Connor or those suggested by the Chairman and Commissioner Bagge? Or, shall we adhere to our position which originally was that no proper record has been made on the compatibility of the lease-sale agreement with the public interest, and in Opinion 565-A was that the lease-sale agreement can now be found to comport with the public interest?

The intention of the parties as expressed in their contract is the touchstone for Commissioner O'Connor's most recent modification of his position. If we were to concur in his presently-expressed position, the only difference *to the producers* between the lease-sale agreement as originally written, and the "conventionalized" alternative would be in the time period for the receipt of their money. They would be charged with "refunding" payments made "too fast," but these "refunds" would be offset by receiving payments for a longer period of time, with an interest component added for the delay.

If we were to concur in Commissioner O'Connor's presently-expressed position, the only difference *to the pipeline* would be in rate treatment of the pipeline. But as we have emphasized in both previous statements of our position, this option has always been open to the Commission without the necessity of "conventionalizing" the transaction.

As far as the consumers (or at least the jurisdictional customers of Texas Eastern) are concerned, it is possible that a "flow-through" of some of the "refunds" temporarily ordered from the producers could have some impact on their rates, but it is highly unlikely that the amounts involved when this case is finally resolved would be large enough to lead to any rate impact whatever. Even if one should occur, the result would be a "vintaging" of customers, by requiring later generations to pay for gas which would otherwise have been paid for in full earlier.

In sum, to join with Commissioner O'Connor in our opinion would be at the price of abandoning our position that the parties deserve to have the courts rule on this transaction with the benefit of our strongly-held views that the transaction is demonstrably in the public interest as originally written.

On the other hand, we must and do withdraw our reluctant concurrence with the Chairman and Commissioner Bagge to the end that the producers can receive the regulated price for the Rayne Field gas for the life of the field.

It is fortunate that the Natural Gas Act makes appeal to the courts a matter of right. As we analyze it, three commissioners do not support any identifiable specific revision of the lease-sale agreement. If the Court of Appeals decides it must be rewritten in some fashion, it may tell us how it believes it should be done. In the meantime, as Commissioner O'Connor suggests, the parties may find a way to settle the matter.

/s/ John A. Carver, Jr.
John A. Carver, Jr., Commissioner

/s/ Albert B. Brooke, Jr.
Albert B. Brooke, Jr., Commissioner

In The

Supreme Court of the United States

October Term, 1975

No. 75-731

Sun Oil Company, General Crude Oil Company,
M. H. Marr, Continental Oil Company,
Petitioners,

v.

Public Service Commission of the State of New York,
Philadelphia Gas Works Division of UGI Corporation,
Texas Eastern Transmission Corporation,
Federal Power Commission,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR RESPONDENT TEXAS EASTERN TRANSMISSION CORPORATION IN LIMITED OPPOSITION

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-731

SUN OIL COMPANY, GENERAL CRUDE OIL COMPANY, M. H. MARR, CONTINENTAL OIL COMPANY,
Petitioners,

v.

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION, TEXAS EASTERN TRANSMISSION CORPORATION, FEDERAL POWER COMMISSION,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR RESPONDENT TEXAS EASTERN TRANSMISSION CORPORATION IN LIMITED OPPOSITION

QUESTION PRESENTED

The petition filed in this case presents two questions. Respondent Texas Eastern Transmission Corporation ("Texas Eastern") opposes Petitioners' application for a writ of certiorari with respect to the second "Question Presented" by Petitioners.[1] Texas Eastern submits that this question is more accurately stated as follows:

[1] Petitioners' first "Question Presented" asks this Court to review the decision of the court below ordering the Federal Power Commission to prescribe refunds by Petitioners based upon an area rate of 18.5¢ per thousand cubic feet (Mcf), rather than the higher rates established by the Commission in Opinion No. 598, 46 FPC 86 (1971). Texas Eastern takes no position on Petitioners' request for a writ of certiorari on this question.

Did the court below err in holding that the Federal Power Commission had improperly implemented its "limited power to raise prices for natural gas above those contractually fixed by the parties."[2]

STATEMENT

A. Background

This case concerns Petitioners' 1958 agreement to sell Texas Eastern their leasehold interests in the Rayne Field, Acadia Parish, Southern Louisiana. The contract provided an aggregate sales price of $134,395,000, to be paid in installments over a sixteen-year period ending in 1975. Under the contract, after 1975 Texas Eastern would obtain gas throughout the remaining life of the Field (then estimated to be 1986) free of cost except for royalties, severance taxes and operating expenses. Although Rayne Field gas began to flow into Texas Eastern's system in 1959, the Rayne Field sale has been in continuous litigation ever since.[3]

On one previous occasion, the Rayne Field sale has been before this Court. In *United Gas Improvement Co.* v. *Continental Oil Co.*,[4] this Court decided an important question of federal law, holding that the Federal Power Commission possesses jurisdiction over the sale to an interstate pipeline of leasehold interests in proven gas reserves in place. The Court disclaimed any intention of reviewing "the pro-

[2] Petitioners' Appendix – hereinafter "App." – A, at p. A54.

[3] *See Texas Eastern Transmission Corp.*, 21 FPC 860 (1959), *rev'd sub nom. Public Serv. Comm'n* v. *FPC*, 287 F.2d 143 (D.C. Cir. 1960); *Texas Eastern Transmission Corp.*, 29 FPC 249 (1963), *rev'd sub nom. M. H. Marr* v. *FPC*, 336 F.2d 320 (5th Cir. 1964), *rev'd sub nom. United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965); *Texas Eastern Transmission Corp.*, Opinion No. 565, 42 FPC 376 (1969), Opinion No. 565-A, 44 FPC 1079 (1970), Order Denying Rehearing, 44 FPC 1471 (1970), *aff'd in part and rev'd in part sub nom. Public Serv. Comm'n* v. *FPC*, App. A., A1-A135 (D.C. Cir. 1974).

[4] 381 U.S. 392 (1965).

priety of the Commission's disposition of the [present] case following its assertion of jurisdiction."[5] Here, the court below held that the Commission's subsequent disposition of the present case, though fundamentally sound in approach, erred in certain particulars. Petitioners seek to attack the court below on two of its findings of error in the Commission's disposition.

B. Proceedings Before the Commission

Following this Court's jurisdictional holding, Petitioners applied to the Commission for certificate authorization of their leasehold sale in accordance with the terms of their contract with Texas Eastern. In response to these applications, the Commission issued Opinion No. 565 (App. F, pp. F1-F103), approving the lease-sale subject to conditions making it substantially closer in nature to a conventional gas sale. In a conventional sale, the parties agree on a price for each unit of gas to be delivered. When certification of a conventional sale is sought, the Commission performs its statutory obligation to protect interstate consumers against excessive prices by conditioning its certificate so as to limit the initial unit price of the gas to a just and reasonable rate, or to a price in line with other analogous transactions, pending formal establishment of a just and reasonable rate. But the Commission found that in a lease-sale transaction it would be impossible to ascertain the cost of the gas per unit until the field had been depleted. In addition, the Commission found that the Rayne Field lease-sale arrangement would apparently produce a higher unit cost than would a conventional sale at the applicable just and reasonable price per Mcf (*id.* at p. F20). Accordingly, the Commission decided to "conventionalize" the Rayne Field sale.

[5] 381 U.S. at 399.

In order to "conventionalize" Petitioners' sale, the Commission attached a number of conditions to their certificates. Among them was the condition that Texas Eastern pay the total agreed purchase price of $134,395,700 at a rate of 18.5¢ per Mcf of production. (App. F at p. F20). The Commission understood that this would entail a longer payment period than originally contemplated (*id.*). Commissioners Carver and Brooke dissented. They noted that "conventionalizing" the transaction to provide instead that Texas Eastern would pay 18.5¢ per Mcf as long as deliveries continued "might require the pipeline to pay more, ultimately, than the 1959 contract provided" (*id.* at F88), but that the approach actually adopted by the Commission provided for less consideration that the contract provided, since the same face amount was to be paid off over a longer period (*id.* at F88-89).

On rehearing, the Commission issued Opinion No. 565-A, which reaffirmed its "conventionalization" approach but modified some of its conditions (App. G, pp. G1-G48). In particular, the Commission decided to abrogate the $134 million lease-sale contract price, requiring instead that Texas Eastern continue to make payments to Petitioners for each unit of gas produced until exhaustion of the Field (App. G at p. G4). Chairman Nassikas and Commissioner Bagge voted to do this "in the interest of bringing about an equitable result" (*id.* at G4), and "to do equity to the parties" (*id.* at G11). "Reluctantly," Commissioners Carver and Brooke concurred in this decision, even though they recognized again that it created "more than a possibility" that Texas Eastern and its customers would ultimately pay an amount that would "greatly exceed" the original contract price, discounted to current dollars (*id.* at G38-39). In their view, this was "preferable to the confiscation involved in assuming that a dollar paid over two years is equal to a dollar paid in one year. Our concurrence goes no further"

(App. G at p. G31). Commissioner O'Connor, the fifth Commissioner, dissented. Emphasizing that his colleagues' "differences of opinion largely focus on who shall have priority in equity" (*id.* at G21), he attacked the majority's decision to allow Petitioners as much as an additional $52,141,000 above the contract price (*id.* at G27).

By a three-to-two vote, the Commission subsequently denied rehearing of Opinion No. 565-A (*see* App. H, pp. H1-H7). But Commissioner O'Connor, who cast the decisive vote against rehearing, issued a concurring opinion arguing for a middle ground. Accepting that "the time value of money must be considered as an element in reaching an equitable disposition of this case," he contended that the $134 million purchase price should be increased *only* by the amount necessary to compensate Petitioners for the additional payment time resulting from the Commission's decision to require payment by the Mcf produced (*id.* at H3-H4). Inclusion of this interest component, he pointed out, would best harmonize "with the intent of the parties as the lease-sale agreement was drafted" (*id.* at H4).

Commissioners Carver and Brooke, dissenting, attempted to "withdraw our reluctant concurrence" in Opinion No. 565-A, in order to deprive of force and effect that opinion's requirement that payment be made over the life of the reserves (*see id.* at H7). Although they adhered to their previous position that the lease-sale should be certificated unconditionally, they recognized that within the conventionalization framework Commissioner O'Connor's suggestion would achieve the goal of preserving the parties' agreement on the sale price (*see id.* at H6-H7).

C. The Decision Below

After subjecting the Commission's orders to searching and exhaustive analysis, the court below affirmed its deci-

sion that the unmodified lease-sale transaction failed to meet the public convenience and necessity standard and would have to be "conventionalized" (A33-A48).[6] However, the court found certain aspects of the Commission's "conventionalization" conditions impermissible, among them its requirement that Texas Eastern continue to pay Petitioners throughout the life of the Field, without regard to the maximum contract price. The court below based this aspect of its decision on this Court's consistent declaration that "the regulatory system created by the [Natural Gas] Act contemplates abrogation of [natural gas companies' contractual] agreements only in circumstances of unequivocal public necessity."[7] The court pointed out that the Commission's decision to eliminate the contract price between Petitioners and Texas Eastern was nowhere predicated on a finding that "unequivocal public necessity" required such a change or that it was essential to the conventionalization of the lease-sale arrangement. Instead, the Commission merely regarded it as "equitable" to remove the $134 million contract price ceiling in order to adjust the difference in time value of the payments received. This did not amount to a finding that the contract price was "so low as to adversely affect the public interest."[8] Nor did the Commission find that "financial or other difficulties . . . required the Commission to relieve the producers . . . from the burdens of their contractual obligations."[9] In fact, "the Commission's alteration of the stipulated aggregate price has not been shown to serve any facet of the public interest at all" (App. A at p. A68).

The court below decided, however, that the Commission's previous decision in Opinion No. 565, retaining the aggregate contract price but spreading payments over a longer period of time than provided by the contract, violated the same principles: it deprived the Petitioners of "the *quid pro quo* for which they contracted" (*id.* at A70), by diminishing the value to them of the face amount of the consideration. It found that, given these principles and the fact that the Commission had repeatedly held conventionalization to be necessary in the public interest, the only alternative legally available to the Commission was to order an increase in Texas Eastern's payments beyond the face amount provided in the contract, but only by an amount equal to the time value of the money to be paid on the Commission's extended payment schedule.[10] In favor of this result, the court advanced the same argument used by Commissioners O'Connor, Carver and Brooke (*see* App. H at pp. H4-H7). According to the court, it "would confer on the producers the full equivalent of their contract price, and would impose on Texas Eastern no more than the equivalent of its contract cost..." (App. A at p. A71). Moreover, this Court's requirement that contractual agreements voluntarily devised must govern, absent a showing that circumstances of unequivocal public necessity otherwise require, would be satisfied (*id.*).

[6] The court first rejected arguments that the changes of position expressed in the dissent of Commissioners Carver and Brooke to the Commission's order denying rehearing of Opinion No. 565-A vitiated the latter, thus restoring Opinion No. 565. The court held that the only effect of the Commission's order was to deny rehearing of Opinion 565-A, thus leaving it unaffected (*id.* at A32).

[7] *Permian Basin Area Rate Cases,* 390 U.S. 747, 822 (1968), citing *United Gas Pipe Line Co.* v. *Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956).

[8] App. A at p. A68, quoting *FPC* v. *Sierra Pac. Power Co.*, 350 U.S. 348, 355 (1956).

[9] App. A at p. A68, quoting *Permian Basin Area Rate Cases,* 390 U.S. 747, 822 (1968).

[10] The court below held that, in lieu of remand for this purpose, its judgment would incorporate such a modification of the Commission's disposition (App. A at p. A71).

D. **Summary of Texas Eastern's Position**

Throughout this extraordinarily protracted litigation Texas Eastern has had two objectives: to secure the Rayne Field reserves for its customers at the lowest possible price, and to recover the costs it has incurred in purchasing Petitioners' interests in those reserves. Texas Eastern believes that, at the aggregate contract price of $134 million, it has attained the first objective.[11] For the sake of both objectives, Texas Eastern would have preferred that the Commission approve the leasehold transaction in its entirety. But the Commission substantially modified the leasehold transaction by attaching conditions to the certificates it issued Texas Eastern and Petitioners, including the condition that eliminated the $134 million ceiling on Texas Eastern's liability to Petitioners, established by the contract.

This condition would deny Texas Eastern an opportunity to recover prudently incurred costs. From the beginning, Texas Eastern has taken care to avoid penalizing present day consumers with costs already incurred but properly attributable to future consumers. Accordingly, it has spread the total cost of its investment, payable in full under the contract by 1975, over the life of the Rayne Field, originally estimated to end in 1986. That is, Texas Eastern charges current consumers only their amortized share of the contract price. As a result, a very substantial portion of the payments Texas Eastern has made to Petitioners remains on Texas Eastern's books.[12] This unamortized balance represents Texas Eastern's investment in the gas to be produced after Petitioners have been paid the total contract consideration. If, however, Texas Eastern is required to continue to pay Petitioners until the exhaustion of the reserves, Texas Eastern will never be able to amortize this portion of its investment. The Commission's condition would invalidate the assumption upon which amortization was based — the assumption that the unamortized portion of the contract price could be charged to the consumers of gas produced after Petitioners had been paid in full.

[11] One Commissioner has twice characterized the Rayne Field transaction as yielding *"the lowest cost of gas of this vintage, including gathering and transmission costs, ever delivered to consumers."* (App. G at p. G21, App. H at p. H5) (emphasis added). Two others have called this sale "a bargain situation for consumers" (App. G at p. G48).

[12] According to the record below, as of 1970 almost $28 million had been paid to Petitioners but not included in rates charged to consumers of Rayne Field gas (R. 6811).

The opinion of the court below affirmed the Commission's decision to conventionalize the lease-sale transaction. But it removed from that decision the features that might have compelled Texas Eastern to seek a writ of certiorari from this Court, including the Commission's elimination of the contract price ceiling. The court remanded to the Commission the other issues that will determine Texas Eastern's ultimate ability to recover its investment (*see* App. A at p. A134-135 and App. C at p. C22 & fn 108). Accordingly, while remaining of the view that unconditional certification would have served the public interest, Texas Eastern does not seek review of the decision below. [13]

Texas Eastern's remaining stake in the present controversy is the risk of a multi-million dollar increase in its

[13] No question is presented concerning the refusal of the court below to grant unconditional certification of the lease-sale. Each of the two questions which Petitioners say are presented here concerns a specific, limited aspect of the Commission's conditions, as modified by the court below. Neither addresses the underlying decision to conventionalize. *See* Petition at p. 2. In the last paragraph of their petition, however, Petitioners imply that they seek a full remand and a *de novo* Commission decision on conventionalization. *See id.* at p. 24. In view of this Court's Rules, Texas Eastern assumes that this suggestion does not affect the scope of review sought. *See* Rule 23(1)(c). However, Texas Eastern does continue to believe that the leasehold sale of Rayne Field reserves should have been certificated unconditionally.

ultimate financial liability on the Rayne Field transaction. As the court below noted, this increase could not be precisely calculated in the course of a Section 7 certification proceeding, if at all (App. A at p. A65). It depends upon the life of the Field and on the outcome of future ratemaking by the Commission. But the minimum estimates of three commissioners range from nearly $18 million to more than $52 million (*id.*). In any event, Texas Eastern contracted for the security of a fixed price, as the Petitioners themselves have previously argued (*see id.* at A46), and based its accounting on the assumption of a fixed price. Texas Eastern accepts that the Petitioners should not "receive less than the *quid pro quo* for which they contracted" (*id.* at A70, A71 & fn. 348). The decision of the court below, ordering adjustment of the contract price to take account of the time value of money, gives Petitioners that assurance. Texas Eastern asks only that it not be required to risk having to pay Petitioners *more* than the quid pro quo for which they contracted.

ARGUMENT

1. The Question Presented Involves Virtually Unique Facts

This Court decided the only new question in this protracted litigation of general interest throughout the natural gas industry when it held that the Commission had jurisdiction to review sales to interstate pipelines of leasehold interests in proven reserves.[14] No one disputes that this decision effectively foreclosed the likelihood that the Commission or the courts will have to consider more lease-sale situations.[15] Thus, though of considerable financial interest to the parties to this case, resolution of the question whether in this case the Commission properly exercised its limited power to raise natural gas prices above those contractually

[14] *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965).

[15] *Cf.* App. F at p. F68 (Carver, Comm'r, dissenting).

agreed upon by the parties to a leasehold sale will not have wide precedential value. Petitioners make no attempt to argue to the contrary.

2. The Question Presented Involves the Application of Settled Law

The court below held that the Commission's deviations in Opinions No. 565 and 565-A from the value of the consideration bargained for by the parties violate settled law. In *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*[16] and *FPC* v. *Sierra Pacific Power Co.*[17] this Court denied that the Natural Gas Act and the Federal Power Act conferred upon the Commission any general power to set natural gas prices above those contractually fixed by the parties. In the *Permian Basin Area Rate Cases*[18] this Court explained under the Natural Gas Act the Commission could raise producers' contract prices "only in circumstances of unequivocal public necessity."[19] The principles have repeatedly been applied, and have never been challenged. Petitioners do not challenge them. Nor do Petitioners assert that their application by the court below conflicts with any decision of this Court or of any circuit court.

Petitioners do, however, intimate that these principles, while valid in the context of Sections 4 and 5 of the Natural Gas Act, should not apply when the Commission invokes its Section 7 power to confer and condition certification. The court below held that this Court's *CATCO* decision[20] makes it clear that the Commission cannot increase the contractually agreed prices absent a finding of compelling public necessity in Section 7 proceedings any more than in proceedings under Sections 4 and 5. Petitioners summarily

[16] 350 U.S. 332 (1956).

[17] 350 U.S. 348 (1956).

[18] 390 U.S. 747 (1968).

[19] *Id.* at 822.

[20] *Atlantic Ref. Co.* v. *Public Serv. Comm'n*, 360 U.S. 378 (1959).

dismiss the court's reading of *CATCO* as "erroneous". Without citation of authority they assert that it is "not reasonable to assume" that the Commission's power to condition a certificate so as to raise the contract price should be limited to circumstances in which public necessity requires such a change. But the very portion of the Natural Gas Act upon which Petitioners rely, Section 7(e), provides in pertinent part:

> The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions *as the public convenience and necessity may require* [emphasis added].

That is, the statute on its face confines the Commission's Section 7(e) certificate-conditioning power to the same circumstances of unequivocal public necessity within which this Court has found the Commission's Sections 4 and 5 contract-modification power to be limited.

3. The Court Below Correctly Decided the Question Presented

After arguing that the Commission can raise their contract price even without attempting to show that the public interest requires this change, Petitioners change their ground and argue that the Commission made the necessary finding. They allege that, contrary to the opinion of the court below, the Commission "*expressly*" found that its condition extending Texas Eastern's obligation to pay over the life of the Rayne Field reserves was "*essential* to conventionalization of the lease-sale arrangement." (Petition at p. 22, emphasis added). In fact, the Commission neither expressly nor implicitly so found. The Commission imposed its condition abrogating the lease-sale contract price "in the interest of bringing about an equitable result" (App. G at p. G4).

Indeed, the authors of the prevailing Commission opinion could not even muster a majority for the proposition that it was "only equitable" (App. G at p. G11) for Petitioners to receive more than they bargained for. Commissioners Carver and Brooke would have prefered to approve the lease-sale arrangement as originally proposed, without conditions. As a second choice, they advocated adjusting the apparent contract price to take account of the time value of money, as the court below subsequently decided to do. Only because they could not find a third vote at that time for either of these alternatives did they supply Chairman Nassikas and Bagge with reluctant support for the condition invalidated by the court below (*see id.* at G30-G31). In short, two members of the Commission that issued Opinion No. 565-A thought that equity called for the condition invalidated by the court below, and another two found this condition, though distasteful, preferable to the condition imposed in Opinion No. 565. No one found it necessary, essential, or required in the public interest. As stated by the court below, "the Commission's alteration of the stipulated aggregate price has not been shown to serve any facet of the public interest at all" (App. A at p. A68).

Petitioners contend that for two reasons the public interest does require Texas Eastern to pay them for each Mcf of gas produced from the Rayne Field until its reserves are exhausted, no matter how much this may increase the aggregate consideration that Texas Eastern contracted to pay and Petitioners agreed to accept for this gas. Their counsel's post hoc rationalizations, which were not the basis of the agency decision in question, would be unacceptable on judicial review in any event.[21] Moreover, Petitioners' "undisputed reasons" would not support a finding that the

[21] *Burlington Truck Lines* v. *United States,* 371 U.S. 156, 168-69 (1962); *Texas Gas Transmission Corp.* v. *Shell Oil Co.,* 363 U.S. 263, 270 (1960); *SEC* v. *Chenery Corp.,* 332 U.S. 194, 196 (1947).

public interest required the challenged life-of-reserves condition even if the Commission, rather than Petitioners, had advanced them for this purpose.

First, the $134 million lease-sale agreement aggregate price would of course be of less value to Petitioners than the contract contemplated to the extent that they receive payment over a longer period than the agreement provided. But the obvious solution, recognized by three Commissioners and utilized by the court below, is to increase the $134 million aggregate by that amount, and only that amount, required to compensate Petitioners for the additional delay in payment. The need to avoid giving Petitioners substantially less than they bargained for can constitute no reason, and certainly not one of compelling public necessity, for paying Petitioners substantially more than they bargained for.

Second, it is obviously true that holding Petitioners to the aggregate price they bargained for, whether or not adjusted for changes in the timing of payment dictated by "conventionalization", would not permit them to receive payment throughout the life of the Field, as would be the case in a conventional sale. But the fact that payment over the life of the reserves is inherent in a conventional sale does not begin to show that similar payment is required by the public interest as a condition of certification of a lease-sale. Petitioners are reduced to arguing that because they would benefit by abrogation of the price term of their contract abrogation must be required in the public interest.

CONCLUSION

For the foregoing reasons the decision of the court below, reversing the Commission's order requiring Texas Eastern to pay Petitioners until the Rayne Field reserves are exhausted, presents no question warranting review by this Court. Insofar as the petition for a writ of certiorari presents this question, it should be denied.

Respectfully submitted,

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FEDERAL POWER COMMISSION,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF FOR PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK IN OPPOSITION

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January 5, 1976

WILSON - EPES PRINTING CO., INC. - RE 7-6002 - WASHINGTON, D. C. 20001

IN THE

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Respondents.

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BRIEF FOR PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK IN OPPOSITION

The Public Service Commission of the State of New York, a petitioner below and a respondent here, opposes the petition for a writ of certiorari filed by Sun Oil Company *et al.*

COUNTERSTATEMENT OF QUESTIONS PRESENTED

1. Whether, in determining the refunds that were properly due under a 1969 Federal Power Commission order granting initial certification for a sale of natural gas that had commenced in 1959 without lawful certificate authority, the court of appeals was required to utilize the rate contained in a 1971 area rate settlement—from which the instant sale had been expressly excluded—rather than the just and reasonable rate in effect in 1969.

2. Whether, in affirming the Federal Power Commission's action in requiring, as a condition to certification under Section 7 of the Natural Gas Act, the conversion of a purported lease-sale of discovered reserves into a conventional sale of gas as produced, the court of appeals erred in limiting the total consideration to be received by the seller to the consideration (adjusted upward for the time-value of money) called for in the seller's contract.

STATEMENT

The background of this much litigated proceeding—now in its nineteenth year and completing its third journey through the appellate courts—is cogently summarized (through 1965) in Mr. Justice Harlan's opinion for this Court in *United Gas Improvement Co.* v. *F.P.C.*, 381 U.S. 392 at 395-99 (1965), and (through 1974) in Judge Robinson's opinion for the court below (Pet. App. A, pp. A-8 to A-22). Both for that reason and also because the issues raised by the petition for certiorari are limited in scope, we include here only those facts essential to an understanding of the issues presented.

In 1957, the four petitioners—Continental Oil Company, Sun Oil Company, General Crude Oil Company, and M. H. Marr—contracted to sell their gas to be produced from the Rayne Field in southern Louisiana to

Texas Eastern Transmission Corporation at an initial price of 23.9¢ per Mcf, substantially higher than any price theretofore proposed for interstate sales in this area, and sought certificate authority from the Federal Power Commission to commence such sale. Following the Third Circuit's 1958 reversal of the Commission's unconditional certification of the 22.4¢ Catco sale,[1] the Rayne producers and Texas Eastern recast their transaction in the form of a "lease-sale", under which the Rayne Field leaseholds would be transferred to Texas Eastern for a lump sum payment of $134,395,700.

Although, depending on assumptions as to ultimate recovery, the unit cost under the lease-sale arrangement would be at least as high as the 23.9¢ contract price, the Commission, in June 1959, granted Texas Eastern certificate authority to effectuate the lease sale, *Texas Eastern Transmission Corp.*, FPC Opinion No. 322, 21 FPC 860.[2] On appeal, the D.C. Circuit reversed, holding that the $134 million cost had not been shown to be justified, *Public Service Commission of New York* v. *F.P.C.*, 109 U.S. App. D.C. 289, 287 F.2d 143 (1960). Notwithstanding the pendency of the ultimately successful appeal, the Rayne Field producers commenced deliveries in mid-1959, and have continued deliveries continuously since.

On remand, the Commission concluded that the sellers' change of the transaction from a conventional sale of gas to a sale of the underlying leases did not affect the

[1] *Public Service Commission of New York* v. *F.P.C.*, 257 F.2d 717 (3rd Cir. 1958), *aff'd sub nom. Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378 (1959). Prior to the Rayne proposal, the 22.4¢ Catco price had represented the maximum for the area.

[2] In its 1959 opinion, the Commission assumed that, because of the lease-sale form of the transaction, it lacked jurisdiction over the sellers and that its sole jurisdiction was over the purchaser, Texas Eastern.

Commission's certificate jurisdiction over the sellers under Section 7 of the Act, and directed the sellers to file applications for certificates to make the sale, *Texas Eastern Transmission Corp.*, FPC Opinion No. 378, 29 FPC 249 (1963). The producers appealed the Commission's jurisdictional holding to the Fifth Circuit, which reversed, *Marr* v. *F.P.C.*, 336 F.2d 320 (5th Cir. 1964); however, this Court granted certiorari, vacated the Fifth Circuit's judgment, and sustained the Commission's holding that it had jurisdiction over the lease-sale transaction, *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965).

Following further hearings before the Commission, a Commission Examiner in 1968 ruled that the producers should refund to Texas Eastern (for refund to Texas Eastern's customers) all amounts collected for 1959-68 deliveries in excess of the 20¢ in-line level (for which the just-and-reasonable level, when arrived at in the nearly concluded area rate proceeding, should be substituted), 42 FPC 455. Shortly after the Examiner's decision in the Rayne case, the Commission issued its final opinion in the area rate case, fixing a just-and-reasonable maximum of 18.5¢ per Mcf for gas of the Rayne Field vintage, *Southern Louisiana Area Rate Proceeding*, FPC Opinion No. 546, 40 FPC 530 (1968), *aff'd sub nom. Austral Oil Co.* v. *F.P.C.*, 428 F.2d 407 (5th Cir. 1970), *cert. denied*, 400 U.S. 950. Thereafter, in August 1969, the Commission issued its basic order reviewed by the court below, FPC Opinion No. 565, 42 FPC 376. So far as pertinent here, the Commission in Opinion No. 565 utilized the 18.5¢-per-Mcf just and reasonable level for sales *after* October 1, 1968 (the effective date of the Southern Louisiana Area Rate opinion), but, with one Commissioner dissenting, utilized the prior in-line price of 20¢ per Mcf to compute refunds for deliveries prior to October 1, 1968. The Commission

further provided that when payments at the revised 20¢ and 18.5¢ levels reached the original price of $134 million, further payments should cease. Petitions for rehearing of Opinion No. 565 were filed by various parties, and, following a lapse of over a year, the Commission in September 1970 entered its order on rehearing, Opinion No. 565-A, 44 FPC 1079, in which it deferred indefinitely any action on the refund issue, and removed the $134 million contract limitation on payments to the producers.

On appeal, the court below, in an unusually comprehensive and scholarly opinion issued March 25, 1974 (Pet. App. A pp. A-1 to A-135), examined with care every contention urged by the various petitioners, concluding, on the points raised by the present petition for certiorari, that the proper refund level for all periods prior to August 1971 (the effective date of a new area rate level promulgated by the FPC in 1971) was the 18.5¢ just and reasonable ceiling fixed by the Commission's 1968 area rate order, and that the total revenues received by the producers, when appropriately adjusted for the time value of money, should not exceed the $134 million price fixed in the original lease-sale contract. In conjunction with the producers' petitions for rehearing, copies of this Court's June 1974 opinion in *Mobil Oil Corp.* v. *F.P.C.*, 417 U.S. 283, were lodged with the court below; in denying rehearing (Pet. App. C, pp. C-1 to C-22), the court ruled that nothing in *Mobil* affected the propriety of the 18.5¢ refund level for pre-1971 sales.

REASONS FOR DENYING THE WRIT

Although this case has been pending for almost nineteen years—during which time it has been the subject of five Examiner's decisions, three Commission opinions, three court of appeals' opinions, and one prior opinion by this Court—the issues sought to be raised by the pe-

tition for certiorari are exceedingly narrow in scope, affecting no general Commission policy, and indeed having no impact on any other proceeding pending before the Commission. The key issue originally raised by the Rayne Field lease-sale transaction was whether the effect of FPC jurisdiction could be avoided by casting a sale in this form, and following the original 1959 opinion by the Commission in this case, other lease-sales were proposed. But once this Court, in its 1965 decision in this case, ruled that FPC jurisdiction applied to the sale of developed leaseholds, no new lease-sales were proposed. The opinion of the court below—dealing with the procedures to be followed to conform a sale improperly commenced as a lease sale to a sale consistent with the public convenience and necessity—is thus *sui generis*, and warrants no intervention by this Court.

On the major issue presented by the petition for certiorari, petitioners do *not* contend that the court below erred in requiring refunds of past overcollections, nor do they contend that the court erred in requiring refunds down to the Commission-determined just-and-reasonable rate level. Petitioners contend merely that the only just-and-reasonable level appropriate for refunds was that approved by the Commission in its 1971 order approving a rate settlement in the second-round Southern Louisiana proceeding.

The essential difficulty with petitioners' position, however, is that petitioners fail to mention—and in consequence fail to suggest any error inhering in—the court of appeals' rationale for refusing to use the 1971 rate settlement level as the refund floor. In its opinion, the court of appeals noted that in 1971, while the Rayne proceeding was pending on appeal, the Commission had, by Opinion No. 598, approved a settlement increasing the Southern Louisiana area rate ceilings, but the court

explained with irrefutable logic why the new ceilings could not affect the determination of refunds for Rayne Field deliveries prior to 1971 (Pet. App. A-132 to A-133, footnotes omitted):

> "Very importantly, however, neither the settlement proposal nor Opinion No. 598 or its related order embraced the refund questions presented in the case at bar. The settlement proposal explicitly admonished that '[t]he terms hereof do not dispose of any issues in the *Rayne Field* (Docket No. G-12446, *et al.*) . . . proceedings'—the litigation now before us—and its refund provisions were expressly made subject to that exclusion. In turn, the Commission, in its words in Opinion No. 598, 'adopt[ed] those provisions of the settlement proposal which prescribe[d] the . . . refund provisions for deliveries made.' And just as the settlement proposal defined the transactions subject to refund in terms excluding the gas sales involved here, so did the order accompanying Opinion No. 598.
>
> "We need not, in these circumstances, consider whether Opinion No. 598 could in any event effect the refunds and flow-through issues which the Commission was called on to resolve several years previous to its promulgation. The critical fact is that Opinion No. 598 left those issues untouched. For that reason, we have concluded that our disposition of the refund and flow-through questions presented on this review must remain uninfluenced by Opinion No. 598."

And, in its opinion on rehearing, the court below, while noting that the higher Opinion No. 598 rate would, under Opinion No. 565, fix the rate for Rayne Field gas sold after August 1, 1971, reaffirmed its view that Opinion No. 598, *by its express terms*, was intended to leave the refund obligation of the Rayne producers exactly where

it would be absent Opinion No. 598 (Pet. App. C-14, footnotes omitted):

> "We concluded in our original opinion that neither Opinion No. 598 nor its related order itself undertook to extend the Commission's retroactive refund formula toward resolution of that question. We pointed out that the settlement agreement underlying Opinion No. 598 stated unequivocally that its provisions would not dispose of any issue confronting us in this litigation; that the refund provisions of the settlement agreement were expressly made subject to that exclusion; that Opinion No. 598 expressly adopted the refund provisions of the settlement agreement as written; and that the order accompanying Opinion No. 598 defined the transactions subject to refund in terms excluding the gas deliveries involved here. We said that '[w]e need not, in these circumstances, consider whether Opinion No. 598 could in any event affect the refund and flow-through issues which [in the instant case] the Commission was called on to resolve several years previous to its promulgation,' for '[t]he critical fact is that Opinion No. 598 left those issues untouched.' All applicants for rehearing seem to concede the validity of that conclusion, and we continue our alliance with it."

Petitioners' present claim that the decision of the court below is inconsistent with Opinion No. 598 and the opinions of the Fifth Circuit and this Court affirming Opinion No. 598 thus rests on the totally mistaken assumption that Opinion No. 598 was designed to govern the Rayne Field refunds. In fact, as the court below recognized, the contrary is true: the Rayne refunds were specifically and deliberately excluded from Opinion No. 598. Thus, petitioners' present position constitutes a collateral attack on Opinion No. 598, and it is the petition for certiorari, and not the opinion of the court below, that is inconsistent with FPC Opinion No. 598 and the court decisions affirming that opinion.[3]

Petitioners also challenge (Pet. 20-24) the court of appeals' reinstatement, at Texas Eastern's instance, of the original Opinion No. 565 condition limiting the producers' ultimate recovery to the $134 million called for in their contracts with Texas Eastern. Since the court adjusted the limitation to give the producers the benefit of the time value of the payment schedule contemplated by the original contracts, it is difficult to perceive how the producers are legally injured by the condition: their only possible loss is that they will not receive *more* than they bargained for. In any event, petitioners have failed to show that, in limiting ultimate recovery to the contract level, the decision of the court below was inconsistent with any decision of this Court or with the decision of any other circuit, or impaired in any way the Commission's discharge of its statutory functions.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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[3] Petitioners' contention (Pet. 19-20) that the decision below is unlawfully discriminatory in that it subjects them to higher refund obligations than other producers in the area has, as noted by the court below on rehearing (Pet. App. C-12 to C-13), been rejected by this Court's opinion in *Mobil Oil Corp.* v. *F.P.C.*, 417 U.S. 283 at 324-25.

No. 75-731

In the Supreme Court of the United States

OCTOBER TERM, 1975

SUN OIL COMPANY, ET AL., PETITIONERS

v.

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

MEMORANDUM FOR THE FEDERAL POWER COMMISSION

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

MEMORANDUM FOR THE FEDERAL POWER COMMISSION

1. This case arises from petitioners' application to the Federal Power Commission under Section 7(c) of the Natural Gas Act, 15 U.S.C. 717f(c), for certificates of public convenience and necessity authorizing their sale to Texas Eastern Transmission Corporation of leasehold interests in natural gas reserves in Rayne Field, located in southern Louisiana. Unlike a conventional sale of natural gas, in which a pipeline agrees to pay the producer a specified price per unit of gas delivered, the proposed lease-sale provided for a total price of $134 million to be paid during a 16-year period ending in 1975, although production from the field was expected to continue until 1986 (Pet. App. A9, n. 14).

Because the total volume of gas to be produced from the field was uncertain, the Commission could not determine

whether the proposed sale price, when viewed in terms of the ultimate cost per Mcf to Texas Eastern, would be consistent with the public interest. It therefore determined to "conventionalize" the sale by issuing certificates of public convenience and necessity subject to the condition that future payments by Texas Eastern for gas produced in Rayne Field would not exceed the then-applicable "in-line" rate of 20 cents per Mcf or other applicable area ceiling rate subsequently established by the Commission (Pet. App. G17).[1] Payments were to continue on that basis for the life of the Rayne Field reserves.[2] Although the Commission had initally included a condition requiring petitioners to make appropriate refunds for rates already collected in excess of the applicable maximum (Pet. App. F44-F45), it ultimately determined to defer consideration of "the appropriateness of refunds or their computation" (Pet. App. G14) pending completion of the area rate proceeding that had recently been reopened (see note 1, *supra*).

2. On petitions for review, the court of appeals affirmed the Commission's orders insofar as they "conventionalize[d] some features of the lease-sale arrangement in the public interest" and "displace[d] the lump-sum lease-sale contract price with an initial unit price for the gas" (Pet. App. A133). The court set aside the orders, however, insofar as they (1) adopted the in-line price of 20 cents per Mcf for gas delivered prior to August 1, 1971,[3] (2) provided that payments should continue for the life of the reserves, and (3) deferred consideration of refunds (*id.* at A134).

The court ruled that the Commission was required to use the 18.5 cents per Mcf just and reasonable rate, rather than the 20 cents per Mcf in-line price, "both as the unit price for the gas deliveries to be made [prior to August 1971] and as the basis for refunds by the producers on account of deliveries already made" (*id.* at A73-A74). Although it recognized that the 18.5 cents rate had been stayed by the Commission, that the area rate proceeding had been reopened, and that the rate was subsequently displaced by a higher rate, the court rejected the Commission's contention that the 18.5 cents rate was "so tentative in character as to support the Commission's refusal * * * to employ [it] * * * as the initial price to be paid to the producers for gas delivered after the effective date of that rate" (*id.* at A84).

The court also held that to permit the producers to collect payments for the life of the reserves would result in total payments greater than the original $134 million contract price and would exceed the Commission's "limited power to raise prices for natural gas above those contractually fixed by the parties" (*id.* at A54).

Finally, the court held that it was improper for the Commission to defer consideration of whether to impose refund obligations. It reasoned that the Commission is ordinarily required to order refunds of rates collected in excess

[1]The Commission had earlier established a maximum "just and reasonable" area rate of 18.5 cents per Mcf, but the order establishing that rate had been stayed by the Commission pending further administrative consideration (see Pet. App. G11-G12). The Commission therefore determined that the "in-line" rate of 20 cents per Mcf should govern in the interim.

[2]The Commission initially determined that payments should cease when the producers had received $134 million, the original total sale price of the leasehold interests (Pet. App. F43). The Commission subsequently recognized that the original contract price "will not be of the same value" under the conventionalized sale, because the producers "will receive it over a much longer period" (Pet. App. G10-G11). The Commission accordingly determined that the proposed sale should be more fully conventionalized and that the pricing conditions should "be extended until the exhaustion of the Field" (*id.* at G11).

[3]That was the effective date of the Commission's final determination, after reopening, of the maximum just and reasonable rate for the Southern Louisiana producing area (46 F.P.C. 86, 142).

of the just and reasonable rate (*id.* at A90) and to do so promptly (*id.* at A95-A99).

The court directed the Commission on remand "to increase, beyond the lease-sale contract price, the aggregate amount which Texas Eastern is to pay the producers by a sum equal to the time value of the monies otherwise to be paid," and "to compute, utilizing the then existing 18.5-cent just and reasonable area rate as the basis, refunds by the producers to Texas Eastern on account of gas deliveries prior to August 1, 1971" (*id.* at A134).

3. Petitioners raise two questions: whether the Commission had authority to conventionalize the lease-sale by extending the payments for gas deliveries over the life of the Rayne Field reserves, and whether the Commission must order refunds of rates collected in excess of an 18.5 cents rate that was never in effect and that has been superseded. We essentially agree with petitioners with respect to the merits on both questions.

(a) The Commission is empowered by Section 7(e) of the Natural Gas Act, 15 U.S.C. 717f(e), "to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require." It properly exercised that broad authority in this case by modifying the proposed lease-sale to make it conform more closely to a conventional sale of natural gas.

The Commission's concern with respect to the pricing feature of the lease-sale was its "inflexibility" (Pet. App. G7). "If the price turns out to be too high in the light of changing circumstances, it fails to protect the consumers; if it is too low the producers will not receive an adequate return and this, in turn, may affect their ability to serve the market" (*id.* at G7-G8). Limiting payments to a specified price per Mcf with an upper limit equivalent to the value of the original lump-sum price—the result required by the

court of appeals—would protect against an unduly high price but not against an unduly low return. The latter purpose was to be served by extending the payments over the life of the Rayne Field reserves. It was within the Commission's authority under Section 7(e) to attach that condition in the public interest.

This Court's decisions in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, and *Federal Power Commission* v. *Sierra Pacific Power Co.*, 350 U.S. 348, do not restrict the Commission's authority to attach appropriate conditions to its issuance of certificates of public convenience and necessity. Those decisions hold that a jurisdictional company may not, merely by filing a new rate schedule, unilaterally change the rate specified in its contract for sales *previously certificated* by the Commission, and that the Commission may order such a change, in disregard of the contract, only upon a finding that the existing rate "is so low as to adversely affect the public interest—as where it might impair the financial ability of the [company] to continue its service" (*Sierra Pacific*, *supra*, 350 U.S. at 355).

Attaching to the issuance of a certificate a price condition that has the effect of increasing the total contract price does not implicate the *Mobile-Sierra* doctrine.[4] In any event, the Commission's finding here—that the lump-sum provision could "affect [petitioners'] ability to serve the market" (Pet. App. G8)—satisfied the relevant standard.

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[4]As this Court stated in *Atlantic Refining Co.* v. *Public Service Commission*, 360 U.S. 378, 391-392, attaching a price condition at the certification stage "is not an encroachment upon the initial ratemaking privileges allowed natural gas companies under the Act, * * * but merely the exercise of that duty imposed on the Commission to protect the public interest in determining whether the issuance of the certificate is required by the public convenience and necessity * * * ."

(b) The Commission determined to defer consideration of refunds until the reopened Southern Louisiana area rate proceeding reached a conclusion. The Commission stated (Pet. App. G14):

> [I]t is our opinion that the public interest precludes our ordering refunds to be paid by the Rayne Field producers at this time. * * * [T]he one objective that must always be kept in sight is the need to provide fair and equal treatment for all of those regulated. It is essential, therefore, that the four producers involved in this proceeding should be afforded the same treatment as will be given to all other producers in Southern Louisiana. In this regard, we believe that the just and reasonable rates which ultimately flow out of any settlement, or further proceedings [in the Southern Louisiana area rate proceeding], should govern the level of payments in this case prior to October 1, 1968, as well as after that date. While we may find ultimately that refunds should be paid, we need not discuss here the contentions * * * with respect to the appropriateness of refunds or their computation (assuming a firm Southern Louisiana area rate).

It is settled that the Commission has "discretion * * * under §4(e) of the Act * * * to refrain from imposing a refund obligation" (*Federal Power Commission* v. *Texaco Inc.*, 417 U.S. 380, 392). It was not an abuse of that discretion to defer consideration of refunds in this case pending the completion of related administrative proceedings concerning the refund obligations of similarly situated producers.

Although "it is the duty of the Commission, 'where refunds are found due, to direct their payment at the earliest possible moment consistent with due process' " (*United Gas Improvement Co.* v. *Callery Properties, Inc.*, 382 U.S. 223, 230), the Commission here did not find

refunds due. Rather, it reasonably determined to postpone consideration of that question. The Commission "was not *required* to delay this refund" (*ibid.*; emphasis added) pending final determination of a just and reasonable rate for the Southern Louisiana producing area, but neither was it precluded from doing so.

Not only did the court of appeals erroneously order the Commission to impose refund obligations "forthwith" (Pet. App. A101), but it insisted that the refunds be predicated "upon the just and reasonable rate of 18.5 cents previously established in the [first] *Southern Louisiana Area Rate Proceeding*" (*ibid.*). The order establishing that rate, however, was never made effective; although it was affirmed by the Fifth Circuit, that affirmance, as this Court later recognized, "was not 'unqualified' " (*Mobil Oil Corp.* v. *Federal Power Commission,* 417 U.S. 283, 310). The Commission was authorized to, and did, reopen the proceeding, and it ultimately established a new just and reasonable rate which was upheld by this Court in *Mobil.*

Since the order establishing the 18.5 cents rate "was therefore not final" (*id.* at 312), and was in fact withdrawn by the Commission prior to the court of appeals' decision in this case (see *id.* at 298, 311; 46 F.P.C. 86, 102), there was no basis for the court's directing the Commission to predicate refunds on that superseded rate. Indeed, the result—treating these producers differently from others in the Southern Louisiana area—is precisely what the Commission had sought to avoid by deferring consideration of refunds.

4. Although the court of appeals' decision, in the respects at issue here, is incorrect, its effect appears to be limited to the peculiar facts of this case. The underlying purpose of the lease-sale agreement that gave rise to this litigation was to attempt to circumvent the Commission's jurisdiction over producer sales of natural gas.

After this Court held in *United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392, that sales of leasehold interests in proven reserves are within the Commission's jurisdiction, no new lease-sales were proposed, and it seems unlikely that such transactions will reappear in the future. The Commission therefore does not believe that the court's decision will seriously interfere with the performance of its regulatory responsiblities under the Natural Gas Act.

Looking solely to the present litigation, however, the Commission believes that the decision improperly requires the imposition of inequitable and unreasonable refund obligations and erroneously compels the Commission to omit a condition designed to protect petitioners' "ability to serve the market" (Pet. App. G8). While those considerations did not seem to be of sufficient general importance to warrant the Commission's seeking certiorari, they do serve to distinguish this case from one in which a court's error affects only private interests. Because we share petitioners' view of the merits, and because the questions presented implicate public interest considerations related to the outcome of this litigation, we do not oppose the granting of the petition for a writ of certiorari.

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FEBRUARY 1976.

In The

Supreme Court of the United States

October Term, 1975

No. 75-731

Sun Oil Company, General Crude Oil Company,
M. H. Marr, Continental Oil Company,
Petitioners,

v.

Public Service Commission of The State of New York,
Philadelphia Gas Works Division of UGI Corporation,
Texas Eastern Transmission Corporation,
Federal Power Commission,
Respondents.

On Petition for a Writ of Certiorari to the
United States Court of Appeals for the
District of Columbia Circuit

REPLY BRIEF OF PETITIONERS

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-731

SUN OIL COMPANY, GENERAL CRUDE OIL COMPANY,
M. H. MARR, CONTINENTAL OIL COMPANY,
Petitioners,

v.

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
PHILADELPHIA GAS WORKS DIVISION OF UGI CORPORATION,
TEXAS EASTERN TRANSMISSION CORPORATION,
FEDERAL POWER COMMISSION,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE
DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF OF PETITIONERS

Sun Oil Company, General Crude Oil Company, M. H. Marr and Continental Oil Company (Petitioners) respectfully submit this Reply Brief to Memorandum for the Federal Power Commission (Commission) and to Briefs in Opposition to the Petition for a Writ of Certiorari filed by Respondents Texas Eastern Transmission Corporation (Texas Eastern) and Public Service Commission of the State of New York (PSC).

Respondent Commission in its Memorandum agrees with Petitioners "with respect to the merits on both questions" raised by Petitioners (Commission Memorandum, p. 4).

The Commission does not oppose granting of the Petition because it "share[s] petitioners' view of the merits, and because the questions presented implicate public interest considerations." (id., p. 8). The Commission's only reservation, which we show is mistaken, is that the decision of the court below appears to be limited to the peculiar facts of this case (id., p. 7).

Texas Eastern in limited opposition also suggests that the case involves unique facts and is not of wide precedential value (Texas Eastern Brief, pp. 10-11). PSC contends that the issues raised "are exceedingly narrow in scope, affecting no general Commission policy, and indeed having no impact on any other proceeding." (PSC Brief, p. 6).

While Petitioners recognize the Court's heavy burden of cases, justice requires that this Court resolve the conflict created by the decision below with the Fifth Circuit's *Placid*[1] and this Court's *Mobil*[2] decisions. The case here is of very large consequence, involving approximately 70 million dollars in refunds to the four Petitioners. This huge burden alone would warrant consideration by this Court. Even as the poorest citizen is entitled to justice, so are Petitioners entitled to redress of the clear errors of the court below whose decision is in conflict with decisions of this Court.

Respondents suggest, without record support, that the Rayne lease sale is a limited, one-time situation which will not recur before the Commission or the courts. This is not true. Judicial cognizance may be taken of litigation now pending before the Commission[3] and the United States

[1] *Placid Oil Company* v. *Federal Power Commission*, 483 F.2d 880 (5th Cir. 1973).

[2] *Mobil Oil Corp.* v. *Federal Power Commission*, 417 U.S. 283 (1974).

[3] *El Paso Natural Gas Company*, FPC Docket CP74-314.

District Court for the Western District of Texas[4] affecting some 89 other lease sale agreements involving natural gas reserves in the San Juan Basin area of New Mexico. In those pending cases, challenges are made concerning Commission jurisdiction over the San Juan lease sale agreements on the ground that those agreements are subject to Commission regulation based on the precedent of the *Rayne Field* case, here before the Court. If the jurisdictional claims are sustained by the Federal Courts or the Commission, there is a strong probability that the *Rayne* conditioning procedure of lease sale certification involved here will be of controlling effect in the Commission's exercise of jurisdiction over these and many other lease sale agreements. Consequently, the instant case may indeed "have wide precedential value" (Texas Eastern Brief, p. 11).

PSC, alone of the Respondents, contends that the Opinion 598 rates affirmed in *Placid, supra*, and *Mobil, supra*, are not applicable to the *Rayne* case (PSC Brief, p. 8). However, PSC misses the crucial point. It is not Opinion 598 *per se* which controls in *Rayne* as to refund levels, but Opinion 565-A, issued in the instant case.[5] More importantly, Petitioners do not rely on *Placid* and *Mobil* merely for their affirmance of the Opinion 598 rate levels, but rather for their complete repudiation and abrogation of the erstwhile Opinion 546 rate of 18.5¢ used by the court below. *Placid* and *Mobil* are controlling here because each affirmed completely the Commission's action in superseding *ab initio* the Opinion 546 rates by Opinion 598 (see Commission Memorandum, p. 7).

[4] *El Paso Natural Gas* v. *Sun Oil Co., et al.*, USDC WD Tex. No. MO 74 CA 57, formerly USDC DC Nos. CA 1761-73, et al., transferred to WD Tex.

[5] This is also made clear by the Commission's Memorandum at pp. 6-7.

CONCLUSION

The petition for a writ of certiorari should be granted.

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February 17, 1976

In The

Supreme Court of the United States

October Term, 1975

No. 75-731

Sun Oil Company, General Crude Oil Company, M. H. Marr, Continental Oil Company,
Petitioners,

v.

Public Service Commission of The State of New York, Philadelphia Gas Works Division of UGI Corporation, Texas Eastern Transmission Corporation, Federal Power Commission,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

PETITION FOR REHEARING

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PETITION FOR REHEARING

Petitioners herein respectfully petition this Court for an order (1) vacating its denial of their Petition for a Writ of Certiorari, entered February 23, 1976, and (2) granting said Petition. In support hereof, Petitioners state as follows:

I.

The Petition for a Writ of Certiorari was filed on November 18, 1975, and two answering briefs[1] had been filed by

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[1] Respondent Texas Eastern Transmission Corporation takes no position regarding the conflict of decisions question (Question No. 1) and limits its opposition to the remaining question presented. Although Respondent Public Service Commission of the State of New York opposes certiorari on both questions, it does not address itself to the clear conflict between the decision of the court below and the decisions of this Court and the court of appeals for the Fifth Circuit presented by Question No. 1 of the Petition.

the time of the initial distribution of this case to the Court in late January. It was not until February 12, 1976, that Respondent Federal Power Commission (Commission) untimely filed its Memorandum in which it agrees that the questions presented by the Petition have merit and states further that these question do involve "public interest considerations" (Commission Memorandum, p. 8). Consequently, the Solicitor General, speaking for the Commission, does NOT oppose the granting of certiorari.

Petitioners were informed by the Clerk's office that this case had been placed on the Court's agenda for its conference of February 20, 1976. Therefore, following receipt of the Commission's belated Memorandum, Petitioners expeditiously filed their Reply Brief in response to all Respondents on February 17th, barely more than two days prior to the Court's conference.

Since the Commission agrees that both questions presented by the Petition have merit of public interest consequence and the other two Respondents either concede or do not directly contest the conflict of decisions questions (Question No. 1), Petitioners assume that certiorari was denied because of the Commission's view that the effect of the errors committed by the court below "appears to be limited to the peculiar facts of this case" and, therefore, will not "seriously interfere" with the performance of the Commission's regulatory responsibilities under the Natural Gas Act (Commission Memorandum, pp. 7, 8).

The late filing of the Commission's Memorandum and the necessarily subsequent filing of Petitioner's Reply Brief, occurring so proximately to the Court's February 20th conference, undoubtedly imposed an undue burden upon the Court. Petitioners have referred in their Reply Brief of February 17th to numerous other lease sales similar to the lease sale here involved which will in all likelihood con-

front the Commission with issues which the instant Petition seeks to resolve. In the circumstances caused by the late filing of the Commission's Memorandum, Petitioners respectfully submit that this situation may not have been fully appreciated either by the Court or the Commission.

II.

The sale of leaseholds by producers to interstate pipelines is not a unique or non-recurring situation. As noted in Petitioner's Reply Brief herein, one example of the far-reaching and recurring nature of such lease sales is presented by pending litigation before the Commission[1] and before the United States District Court for the Western District of Texas.[2] Both the above pending complaint before the Federal Power Commission and the suit before the Federal District Court affect 89 lease sale assignments by numerous producers, including two of the Petitioners,[3] of their gas leases in the San Juan Basin area of New Mexico. In those cases, the interstate pipeline buyers, California distribution customers, and California Public Utilities Commission are asserting that the assignments of leases by the producers to the pipelines constitute sales of natural gas subject to Commission regulation under this Court's decision in the Rayne case.[4] The San Juan lease sale agreements to El Paso were concluded in the early 1950s. After more than twenty years those lease sale agree-

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[1] *El Paso Natural Gas Company,* FPC Docket CP74-314 — Petition and complaint for order to show cause to assert FPC jurisdiction over lease sales to El Paso.

[2] *El Paso Natural Gas Co.* v. *Sun Oil Company, et al,* U.S.D.C., W.D. Tex. No. MO74-CA-57, formerly U.S.D.C., No. CA1761-73, et al, transferred to W.D. Tex. — Suit by El Paso to establish Commission jurisdiction over producers who had conveyed leases to El Paso.

[3] Continental Oil Company and Sun Oil Company.

[4] *United Gas Improvement Co.* v. *Federal Power Commission,* 381 U.S. 392 (1965).

ments are now being vigorously litigated on the question of Commission jurisdiction. If the jurisdictional claims are sustained, the Rayne conditioning procedure of lease sale certification at issue here will be of controlling effect.

In addition to the twenty-year-old San Juan lease sale agreements, there are many other cases of lease assignments by producers to interstate pipelines or distributors which may come before the Commission if they are determined to be jurisdictional. Even today, brand new agreements similar to the San Juan lease assignments are being negotiated in the same area of New Mexico to transfer gas reserves to a natural gas utility for resale in interstate commerce.[1]

A further example of conveyance of producing proved and developed gas leaseholds from a producer to an interstate pipeline is the case of *Tara Petroleum Corporation,* at FPC Docket No. CI75-337, which was decided by the Commission on February 25, 1976, subsequent to this Court's denial of certiorari. In *Tara,* the Commission issued an order permitting the producer to abandon its certificate covering the sale for resale of natural gas in interstate commerce to Kansas Nebraska Natural Gas Company from the Syracuse Field, Kansas. A condition of the producer's abandonment of its certificate was the conveyance of the producing, proved and developed gas leases to the interstate pipeline. The assignment of leases was made to continue the interstate sale for resale of the gas reserves involved.

The above cases illustrate the frequent instances of lease sales or assignment of natural gas reserves underlying gas

[1] Again, one of the petitioners in this case, Continental Oil Company, is involved in these negotiations which involve proposed conveyance of natural gas leases in the San Juan Basin to a natural gas utility, for transportation and resale in interstate commerce.

leases by producers to interstate pipelines for resale in interstate commerce. Such assignments of gas leaseholds are not limited to the instant Rayne case, and indeed are a recurring situation. The decisions of the court below and the Commission in conventionalizing such leasehold sales of gas reserves will be of increasing precedential importance.

III.

In their Petition filed November 18, 1975, Petitioners did not present as a separate question the larger issue of public interest involved in the overstepping by the court of appeals of the bounds of its reviewing authority in the course of the two erroneous actions of direct injury to Petitioners.

In the light of the Petition for Rehearing and Clarification of Respondent Federal Power Commission before the court of appeals, Petitioners were reasonably justified in expecting the Commission itself to carry forward its contentions that the choice of alternatives is essentially one for the administrative agency and that if error is found the court below may not impose upon the Commission a result which is not necessarily the only alternative available, citing *Federal Power Commission* v. *Idaho Power Company,* 344 U.S. 17 (1952) and related authority.

Contrary to Petitioners' expectation, the Commission did not here advance its public interest question. By its Memorandum of February 12th, filed shortly before the February 20th conference of this Court, the Commission expressly acknowledged that the court of appeals' decision was in error in directing the Commission to predicate refunds on a superseded rate, and in restricting the Commission's authority to determine the appropriate certificate condition extending payments for the life of the field (Commission Memorandum, pp. 5, 7 and 8).

After filing of the Petition herein, this Court authoritatively stated the limitations upon the power of the court of appeals to enter into the field of administrative discretion by the issuance on January 19, 1976, of its summary *per curiam* order in *Federal Power Commission* v. *Transcontinental Gas Pipeline Corp.*, No. 75-584, ... U.S. ...., 44 USLW 3413, granting the petition for certiorari of the Commission, vacating the order of the court of appeals and remanding for further proceedings consistent with this Court's opinion.

In *Transcontinental,* the Commission had argued that the court of appeals overstepped the bounds of its reviewing authority in ordering an investigation by the Commission and in doing so had unwarrantedly interfered with the internal functional autonomy of an independent administrative agency. This Court agreed with that view in the following language:

> "Third. We are of the view, however, that the Court of Appeals overstepped the bounds of its reviewing authority in issuing the order presently before us. First, we have consistently expressed the view that ordinarily review of administrative decisions is to be confined to 'consideration of the decision of the agency . . . and of the evidence on which it was based.' United States v. Carlo Bianchi & Co., 373 U.S. 709, 714-715 (1963). '[T]he focal point for judicial review should be the administrative record already in existence, not some new record initially made in the reviewing court.' Camp v. Pitts, 411 U. S. 138, 142 (1973). If the decision of the agency 'is not sustainable in the administrative record made, then the . . . decision must be vacated and the matter remanded . . . for further consideration.' Id., at 143. Clearly it is this mode of review that is contemplated by the statute providing for judicial review of Commission decisions, § 19(b) of the Act, 15 U.S.C. § 717r(b). Secondly, although we have recognized that a court reviewing decisions of the Federal Power Commission sits as a court vested with equity powers and 'may authorize the Commission in proper circumstances to take new evidence', Mobil Oil Corp. v. FPC, 417 U.S. 283, 311-312 (1974), it is nevertheless true that ordinarily this will require a remand to the agency in order that it can exercise its administrative discretion in deciding how, in light of internal organizational considerations, it may best proceed to develop the needed evidence and how its prior decision should be modified in light of such evidence as develops. Certainly this is the procedure contemplated by the review statute which provides that the Commission 'may modify its findings as to the facts by reason of the additional evidence so taken', and that such modified or new finding, '. . . if supported by substantial evidence, shall be conclusive. . . .' 15 U.S.C. § 717r(b)." *id.* at 3414.

The belated Memorandum of the Solicitor General for the Commission in the present matter may have failed sufficiently to direct the attention of this Court to the persistence of the error of the court of appeals in its improper intrusion into the administrative function. In explanation of its failure consistently to protect the Commission's domain, the Memorandum takes the position that the court of appeals' decision would not "seriously interfere with the performance of its regulatory responsibilities under the Natural Gas Act" (Commission Memorandum, p. 8).

Aside from the cogent question of how seriously the improper arrogation of authority by the court below may injure Petitioners, the Commission was remiss in its failure to recognize the vigilance required of it to protect against improper judicial intrusion, regardless of the scope of the foray. The course of conduct should not depend upon whether the Commission thinks it can survive small, but not large, judicial assumptions. Petitioners respectfully submit that there is a matter of sufficient general interest

to the jurisprudence and the preservation of the proper bounds of administrative and judicial authority involved in the present case to justify the type of action taken by this Court in *Federal Power Commission* v. *Transcontinental Gas Pipeline Corp., supra,* by granting certiorari and remanding this case to the court of appeals for further consideration.

The Commission felt honor bound to make amends by suggesting that it might be right, after all, to grant the Petition as a matter in which more than private interests are affected, saying "Because we share petitioners' view of the merits, and because the questions presented implicate public interest considerations related to the outcome of this litigation, we do not oppose the granting of the petition for a writ of certiorari" (Commission Memorandum, p. 8).

CONCLUSION

Petitioners believe that it is clear that certiorari should be granted, for the reasons here presented, as well as those presented in their original Petition. Accordingly, Petitioners respectfully request the Court on rehearing to vacate its order of February 23, 1976, denying certiorari and to grant the Petition for writ of certiorari.

Respectfully submitted,

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March 11, 1976

CERTIFICATE OF COUNSEL

As counsel for the petitioner Continental Oil Company and on behalf of petitioners Sun Oil Company, M. H. Marr and General Crude Oil Company, I hereby certify that this petition for rehearing is presented in good faith and not for delay and is restricted to the grounds specified in Rule 58(2).

....

TOM BURTON
Counsel for Petitioners

March 11, 1976